PREFATORY NOTE

These transcripts have been produced from the original raw transcripts in the FOMC Secretariat's files. The Secretariat has lightly edited the originals to facilitate the reader's understanding. Where one or more words were missed or garbled in the transcription, the notation "unintelligible" has been inserted. In some instances, words have been added in brackets to complete a speaker's thought or to correct an obvious transcription error or misstatement.

Errors undoubtedly remain. The raw transcripts were not fully edited for accuracy at the time they were produced because they were intended only as an aid to the Secretariat in preparing the records of the Committee's policy actions. The edited transcripts have not been reviewed by present or past members of the Committee.

Aside from the editing to facilitate the reader's understanding, the only deletions involve a very small amount of confidential information regarding foreign central banks, businesses, and persons that are identified or identifiable. Deleted passages are indicated by gaps in the text. All information deleted in this manner is exempt from disclosure under applicable provisions of the Freedom of Information Act.

Meeting of the Federal Open Market Committee

October 4, 1983

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, October 4, 1983, at 9:00 a.m.

PRESENT: Mr. Volcker, Chairman
Mr. Solomon, Vice Chairman
Mr. Gramley
Mr. Guffey
Mr. Keehn
Mr. Martin
Mr. Morris
Mr. Partee
Mr. Rice
Mr. Roberts
Mrs. Teeters
Mr. Wallich

Messrs. Boehne, Boykin, Corrigan, and Mrs. Horn, Alternate Members of the Federal Open Market Committee

Messrs. Balles and Black, Presidents of the Federal Reserve Banks of San Francisco and Richmond, respectively

Mr. Axilrod, Staff Director and Secretary
Mr. Bernard, Assistant Secretary
Mrs. Steele, Deputy Assistant Secretary
Mr. Bradfield, General Counsel
Mr. Oltman, Deputy General Counsel
Mr. Kichline, Economist
Mr. Truman, Economist (International)

Messrs. Balbach, R. Davis, T. Davis, Eisenmenger, Prell, Scheld, Siegman,1/ and Zeisel, Associate Economists

Mr. Cross, Manager for Foreign Operations, System Open Market Account
Mr. Sternlight, Manager for Domestic Operations, System Open Market Account

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1/ Entered the meeting after the action to approve the minutes of the August 23, 1983, meeting.

Mr. Coyne,1/ Assistant to the Board of Governors
Mr. Kohn, Deputy Staff Director, Office of Staff Director for Monetary and Financial Policy, Board of Governors
Mr. Lindsey, Associate Director, Division of Research and Statistics, Board of Governors
Mr. Gemmill, Senior Associate Director, Division of International Finance, Board of Governors
Mr. Roberts, Assistant to the Chairman, Board of Governors
Mrs. Low, Open Market Secretariat Assistant, Board of Governors

Mr. Forrestal, First Vice President, Federal Reserve Bank of Atlanta

Messrs. J. Davis, Keran, Koch, Mullineaux, and Stern, Senior Vice Presidents, Federal Reserve Banks of Cleveland, San Francisco, Atlanta, Philadelphia, and Minneapolis, respectively

Mr. Broaddus, Vice President, Federal Reserve Bank of Richmond

Mr. Pearce, Assistant Vice President, Federal Reserve Bank of Dallas

Ms. Lovett, Manager, Securities Department, Federal Reserve Bank of New York

1/ Entered the meeting after the action to ratify transactions in the System Open Market Account.

Transcript of Federal Open Market Committee Meeting of
October 4, 1983

[Secretary's note: The meeting began with the approval of the minutes of the previous meeting.]

MR. CROSS. [Statement--see Appendix.]

MR. STERNLIGHT. [Statement--see Appendix.]

[Secretary's note: The Committee ratified the transactions of the Desk.]

MR. KICHLINE. [Statement--see Appendix.]

MR. BOEHNE. I wish I had a story that was different, just for the sake of excitement, but I really don't. It seems to me that Jim has pretty well captured what is going on. We find that in our District things generally are improving. Even an area like Johnstown, Pennsylvania, which does not qualify as a garden spot, seems to be feeling pretty good. The unemployment rate has dropped from 25 to 20 percent, so they think the recession is indeed over! Single-family construction, however, is an exception. Philadelphia has either been hit earlier or some special factors are going on there; there has been a really major drop in the last 30 days in housing construction. Some of it probably reflects the running out of the pent up demand that existed. But I think the mortgage interest rate is in an area where there is a great deal of sensitivity toward new mortgage activity. This weakness is largely in single-family construction, however, and is not in the multifamily area; that seems to be holding up.

Just one point on business fixed investment: Normally in this part of the recovery, one would expect to see a bigger pickup in steel activity. While there has been some, it's not as much as one would expect. One of the reasons--at least an explanation that the steel people give--is that with business fixed investment being largely concentrated in equipment, particularly office equipment, that just doesn't have the same steel content as other parts of that category traditionally have had and, therefore, there hasn't been the increase in steel orders. On inventories, for businessmen to say that they are building inventories I find is almost like saying they are for inefficiency because they have been trained so much to cut inventories. But I do detect an increase in inventories as the confidence level has increased. On the price side, we are picking up indications and stories of some price pressures in industries such as chemicals and paper and apparel. But the pressures seem to be very spotty and bottlenecks seem to be very localized. One story I heard about in the aluminum business is that, with the tandem trailers now being legal, aluminum production has increased and there is a shortage in what are called aluminum logs that [are used to construct] the sides of those tandems because of the increase in demand. So, there are some localized price pressures, but I certainly can see nothing in my area that would be of a generalized nature.

VICE CHAIRMAN SOLOMON. I don't think there is much difference of opinion in the financial community about the current situation and the near-term prospects for economic growth. What I found interesting, though, was a private discussion I had the other day with on the one hand and one I had with and [unintelligible]. The views varied sharply. and [unintelligible] believed that capital spending would continue in 1984 along typical recovery [trends]; therefore, [for that reason], along with other factors, they concluded that interest rates will rise at least 100 to 150 basis points over the next year. sees no evidence that capital spending will be that strong and he doesn't believe that the inventory replenishment will continue beyond the spring. He says he doesn't believe it is going to return to a statistically normal ratio because he thinks it is ridiculously low now and can't reflect completely the reality. And unless he is wrong about inventory replacement, he believes that the recovery will peter out sometime toward the end of the first half of next year. I would say that the view is probably a minority view in the financial community. There would be more people reflecting the former view. And then there is a monetarist view, reflected by an Englishman with whom I had a conversation, He's saying that inflation in this country by the fourth quarter of next year will be between 8 and 10 percent and that the inflation rate in Germany also will be very high, based on his approach to analysis. So, in some ways, the question of 1984 prospects and the so-called crowding out effect of the budget deficit is much more interesting than the current situation. But I don't have any real difference of view from that which Jim expressed with regard to the current situation. I would add one comment on the current situation, which is that aside from the distorting effect of high real interest rates on different sectors in the economy, there is also the distorting effect of the exchange rate, which is making the composition of what look like normal overall figures somewhat different than we've had before, with certain sectors still being very badly impacted.

MS. HORN. We in Cleveland agree for the most part with the staff's forecast. To the extent we see risks in it, we see the risks on the down side--that is, growth not coming through in '84 as strongly as forecast for a variety of reasons. One reason, of course, is the outlook for investment--capital goods and heavy industry--which is exacerbated by the budget. I just have a couple of comments to make on that industry. I'm really focusing now on the components of that industry that we have in the Fourth District--steel, machine tools, heavy trucks, and mining related to metal production. There has been some turnaround but it has been modest. And I think the continued slowness in those industries is leading the managers to come to some pretty hard decisions. Some are coming to the decision that recovery won't answer their problem--that their problem is deeper than will be dealt with by economic recovery. Those who haven't quite come to that point yet at least feel that the recovery might be too slow to be very helpful to them or that perhaps they are going to be crowded out in this case. I think that's bringing them to some short-term solutions; I don't think we see the examples yet of the long-term solutions such as trying to get competitive in world markets and so forth. I suppose the worst of the short-term solutions, which we have seen for some time, is a call for protectionism. But there are other kinds of solutions as well. I suppose my remarks are inspired today in part by the LTV steel situation--the merger between J&L and Republic--which does seek to deal with problems in the short run by reducing capacity and by dealing with the overhead problem. Now, in the long run maybe they aren't going to deal with labor contracts and maybe they aren't going to deal with capital investment and a number of the other tougher problems. I'm not sure what kind of financial strength they're going to end up with after this merger, but I think it is at least one indication of an attempt that is going in the right direction toward finding short-run solutions to problems. We see other less dramatic examples in the Fourth Federal Reserve District, too, of attempts to get their hands around the short-term problems--in machine tools, for example. I just thought I would bring up those comments relative to capital goods and the outlook for heavy industry today.

MR. MARTIN. Is concessionary [wage] bargaining a part of the so-called short-run solution? You didn't mention it.

MS. HORN. I didn't mention it, and it certainly has been happening over a period of time in the Fourth Federal Reserve District. I guess it's a mixed bag. There are some real concessions; some of the heavy companies, for example, have gotten escalator clauses out of their [labor] contracts. But there is the problem that the union people who come to vote in the elections are the people who still have the jobs and they can have a short-run attitude. We find, for example, that the Chrysler contract that recently was voted for 2 to 1 across the country was voted 1 to 2 in the Fourth District the other way. So, I think it's a very mixed bag in terms of the labor concessions. I don't read it as really being [in one] direction.

MR. RICE. In announcing the LTV merger did they say they intended to reduce capacity in the industry?

MS. HORN. Yes. Well, [I'm not sure if] there was a public statement by the company or not. They certainly have been very clear in discussions that they are going to cut heavily into the capacity, particularly at Republic Steel but at J&L as well.

CHAIRMAN VOLCKER. Two-thirds of the Chrysler workers in Ohio voted against the 12 percent [wage] increase?

MR. PARTEE. What, they wanted more?

MS. HORN. That's right.

MR. PARTEE. I didn't figure they wanted less! [Laughter]

MR. GRAMLEY. But looking at the wage picture generally, the astonishing thing is the extent to which we're still getting give-backs and freezes. The Board staff's latest memorandum on wage concessions says that concession bargaining was extensive again in the third quarter; at least 150,000 workers agreed to wage freezes or pay cuts just in that quarter. And the latest wage concessions bring the cumulative number of workers who have acceded to give-backs so far this year to around a million compared with two million in 1982. I think we still are getting indications of very, very substantial moderation in wage rates.

MR. PARTEE. And the aggregate wage figures are not going anywhere.

MR. GRAMLEY. That's right. Wage rate figures for the third quarter confirm what is going on in the union sector.

CHAIRMAN VOLCKER. Well, you can look at that somewhat differently. There isn't any question that they are still getting concessions, but what is holding up the average? What are they getting in areas where there aren't concessions?

MR. GRAMLEY. Well, I'm not sure the average is holding up. We don't have an employment cost index for the third quarter and the average hourly earning figures are a little difficult to read now because the latest employment situation report has a big strike figure in it. I don't know what the August numbers will look like once the strike effects are taken out, but indications for the third quarter so far are for a slower rise in average hourly earnings this quarter than in the previous one.

VICE CHAIRMAN SOLOMON. But isn't it still close to 7 percent for the country as a whole?

MR. GRAMLEY. Hours? For the wages it's more like 4 percent.

CHAIRMAN VOLCKER. It's 4 percent but a lot of industries, such as the utilities industry, [are higher]. I'm just looking at some figures here that somebody gave me on collective bargaining agreements and they are all more than 6 percent; many of them are 8 percent. That's down 1 or 2 percentage points from the peak levels in an industry that isn't under exceptional pressure. They can always pass it on to the customer.

MR. GRAMLEY. We're going to get that in industries where the [competitive] pressures are not there. But they are surely being counterbalanced.

CHAIRMAN VOLCKER. Well, you remember what happens when these pressures go away. The next report could have an expansion. Wages could settle down.

MR. BOEHNE. There are more industries where that restraint is not present than where it is. Just look across the board. In the heavily unionized heavy industry types of companies you find that. You don't find it much in the financial sector; you don't find it in the service sector generally.

MR. WALLICH. I think there is an enormous catch-up demand in all these areas where concessions have been made. It's natural that they regard that as a temporary calamity and will try to catch up again. Chrysler showed that.

MR. MARTIN. There is an institutional element in this too that is coming up, particularly next year, and that is the turnover in union leadership. In more and more cases the senior captains of those unions are retiring and new faces are appearing. And there's going to be a certain amount of motivation among those folks to make the record show that those old boys, and old women in some cases, had gotten tired. I think that's a factor that we have to watch in 1984.

MR. FORRESTAL. Mr. Chairman, we don't have any esoteric tales either to report from the Sixth District. We would generally agree with Jim Kichline's estimate. I think the Southeast pretty much mirrors what is going on in the rest of the country. The economy continues to expand, although there are a few sectors that are showing some signs of slowing. Consumer spending remains pretty strong, although the drought and the unseasonably hot weather affected not only farm prices but consumer spending as well because there were not the usual back-to-school purchases. Industrial employment is continuing to rise. We're looking at some reversals, particularly in the forest industry. [That experienced by] Georgia Pacific, which recently moved to Atlanta, is very much apparent to us in that particular industry. Higher mortgage rates have reduced sales of new homes from the levels that were attained earlier this summer. It seems to me that 13-1/2 to 14 percent rates are about the choke point for most people for new homes as well as existing homes.

In the financial sector we've had pretty good deposit and loan growth, although it has been weaker than in June. It's going to be interesting to see what the results of the deregulation move on October 1 will be. I believe that somewhere in the Bluebook or Greenbook there was an indication from the staff that there was not going to be as much hype in advertising for these new instruments as there was before. We don't expect it to be very extensive in Atlanta or in the Southeast, but we do think that it's going to take off to some extent--that there is going to be more advertising and more attempts to draw funds through these instruments into the banks and the S&Ls. Tourism is showing some signs of ebbing particularly in central Florida, and in the Miami area the tourist industry is a disaster. They are doing very badly and that's true not only in Miami Beach and Miami but in Dade County generally.

If we had some concerns to express--where we would differ from the staff estimate--it would be on the up side. We think that perhaps there has been some underestimation of the strength of the economy. That is certainly true in our area; we get people talking about this quite a lot in our section of the country. After all, throughout this third-quarter period we did have some strikes, such as the AT&T strike, which I think had an effect on the economy. We had the hurricane in some parts of the country. I think we have to take that into account. So, we would be a little concerned that the third-quarter number is perhaps on the low side and might be revised upward. There is considerable concern in our District, as I'm sure there is in other Districts, about the [federal budget] deficit, and there's a great deal of concern in the export-related industries about the strength of the dollar. Interestingly, inflation in two of our major cities, Atlanta and Miami, is running about 1.3 to 1.4 percentage point above the national average, so that's a concern. Because of already existing inflation in those cities and the threat of increased food prices as a result of the drought, we see some pressure on prices.

One other thing I might mention is related to industrial production and capital expansion. Some of the contacts we've had with industrial development agencies around the District indicate to us that a lot of the capital expansion is being designed to improve existing productivity rather than to meet additional product demand. And finally, Mr. Chairman, there is a good deal of concern in Atlanta and Miami about the Eastern [Airlines] situation. Governor Martin's remark about concessionary bargaining certainly bears on this. This is a good example of the union leaders not being supported by their own people. I'm not sure they're in the old man/old lady category but the flight attendants, for example, are now coming forward and indicating that perhaps they would rather have wage concessions than have Eastern go under. In other words, they are tending to believe management rather than their own union.

MR. PARTEE. I thought the indication was that that was non-union people.

MR. FORRESTAL. No, the flight attendants are unionized. And they have been mounting a petition in both those cities, Atlanta and Miami, to accept some form of wage concession. They are saying Frank Bowman ought to be believed that the losses are going to be extensive, and it's better to have a 15 percent pay cut than no job. Where the pilots and the others in that company are, I'm not sure. Obviously, the effect of anything happening to Eastern would be devastating in our part of the country because Eastern and Delta account for about 90 percent of all traffic out of Atlanta's airport. So, we're watching that situation pretty carefully.

CHAIRMAN VOLCKER. Mr. Morris.

MR. MORRIS. Well, Mr. Chairman, I've been looking for some signs of crowding out in the staff projections; I don't see any through 1984. Presumably, if nothing is done on the budget deficit, we will reach a point where the total demand for credit is going to require some reduction in housing, but apparently that is not going to take place in 1984. I assume it's because the corporate financing gap, which is projected to be negative this year, is very small next year. Have you attempted to calculate when this day of reckoning is going to be if it's not in 1984?

CHAIRMAN VOLCKER. Let me interject a question or a comment. I don't understand this "either/or" crowding out theory. It seems to me that interest rates are relatively high and that the deficit is relatively high and there's already crowding out in some sense [unintelligible] more investment and more housing.

MR. MORRIS. Well, what I meant is the level of crowding out that would require a substantial reduction in housing from the current level.

CHAIRMAN VOLCKER. Their projection shows a reduction in housing.

MR. MORRIS. They show 1.8 million starts in the last quarter of '84.

MR. KICHLINE. Well, we don't have a good answer to your question. I would say that, from our point of view, interest rates are significantly higher now than they would be in the absence of a $200 billion average deficit on the part of the government. So, in that sense, clearly there is some degree of crowding out. You're quite correct in noting that what holds this forecast together in not seeing really bad things materializing early on in 1984 is a very strong business picture. That is, internal funds generation in the forecast is very strong; profits growth is very high. And investment, while growing, simply doesn't match what we're seeing on the business side. So, the combination really of the foreign sector--foreign inflows--plus business savings has been able to offset what would be more apparent crowding-out effects. You're right that in the forecast we don't see at this point a collapse in housing. [Housing demand] clearly is not growing much and it's lower than one might have expected otherwise. Consumer borrowing, I might note, is very strong in this forecast. Looking at this now, one of the problems, it seems to me, is that while we have reduced business borrowing--the negative financing gap--we have very strong consumer spending and consumer borrowing in this forecast.

MR. BOEHNE. Isn't part of the answer that when we think about crowding out we have a mind set that goes back to the days of Regulation Q? And now, with interest rates largely deregulated, there isn't an abrupt point where funds just simply aren't available; it's a more gradual situation. I don't think we're going to see a fellow jump out of a box and say: I'm Mr. Crowding Out. It seems to me it's going to be much more gradual. Interest rates will be higher than they otherwise would be and there will be distortions in the mix of GNP; I think we have some of that right now.

MR. BALLES. Mr. Chairman, I'd like to add to what Ed just said. I think there are some signs on the horizon already of this crowding out. It's true that housing starts nationally continued to go up in August, but in the state of Oregon, for example, there was no increased production of lumber even in the face of that. Sales were made out of fairly high levels of inventory at the plant level and at the retail level, and that's because they expect the corner to be turned in the near future. They look at such things as what is going on in the sales of new single-family homes, and in that area there were declines two months in a row--in July and August. The lumber industry feels that that becomes a harbinger of what is going to happen in the near future to housing starts. Once a housing start is under way, of course, [the builder] has to complete that house. So, even though the demand may be weakening in terms of ultimate purchases, housing starts continue to look solid for a while. But I think this indication that sales of new single-family homes are already starting to decline, down two months in a row, is a concrete sign that the squeeze is being put on that industry by high interest rates.

CHAIRMAN VOLCKER. What has happened to lumber prices in the last few weeks?

MR. KICHLINE. They've been coming down.

MR. MORRIS. The answer is that they haven't looked into '85 far enough. Pretty clearly, the problem is going to come when the corporate financing gap starts to grow, and that means a counter-balancing decline in housing to permit that financing to take place. And the question is: When does that process start?

MR. RICE. Also, partly in support of Frank, over the next year we're projecting a slight decline in long-term interest rates. That would argue against any buildup of crowding out.

VICE CHAIRMAN SOLOMON. Are you speaking of long-term--?

MR. RICE. We're projecting a decline in long-term interest rates of about 1/2 percentage point.

MR. PARTEE. We vary quite a bit from Wojnilower and Kaufman.

VICE CHAIRMAN SOLOMON. Let me ask whether the staff has gone through a hypothetical scenario that I tried to go through, very inconclusively. That is, next year we're probably going to be running a trade deficit of about $110 billion and a current account deficit of $70 or $80 billion. What happens if, notwithstanding the high level of interest rates, expectations regarding exchange rates change radically and we see the exchange rate falling substantially? That has implications of a reversal--a major reduction or a complete cessation--of net capital inflows. Now, what's the effect on interest rates? As we analyze it, there probably would be some upward movement, but there would be an improved differential in the dollar market against the Eurodollar market and there would be reflows from the Eurodollar market brought in by the banks. The composition of the capital movements would change substantially. The interest rate effect probably would be not too significant here at home and/or we would have a dramatic change in the exchange rate. But I want to be sure of this kind of analysis. If anybody on the staff wants to comment on what they think the impact, if any, would be from this on domestic interest rates, I'd be interested in hearing.

MR. TRUMAN. Well, you might want to separate the question about what will happen as a natural course of events as distinguished from what might happen. I was, in fact, sitting here asking myself a slightly different question: What if the dollar declines more rapidly than we now anticipate in the forecast? That would tend to have an expansionary effect on the economy just because aggregate demand goes up. Once you get the impact of that larger decline on the current account, you are going to get an increase in aggregate demand in the economy. And through that mechanism alone, leaving aside the direct effect on prices, you're going to have some inflationary push. You might argue from that standpoint that there would be an induced increase in the average level of interest rates coming from the higher level of nominal income. Now, there is always the timing problem: The dollar initially falls and there's not going to be any change in the short run in the current account. So, whatever the net capital inflow is going to be, for a period the lags that most economists think are there will continue to be there. It might have some compositional effects. Whether it would take the form of flows through banks or inflows through the flow of funds, I'm not quite sure. Whether the intervention and purchase of government securities in itself through different channels will affect the general level of interest rates is a more difficult question to answer.

VICE CHAIRMAN SOLOMON. Can you see any clear effects on the monetary aggregates resulting from the changes in the composition of the flows?

MR. TRUMAN. Whenever we're asked the question from Congress we tend to say no. I guess what you're saying is that there is a tendency for some magnitudes to rise more rapidly than others. Most of the research would suggest, at least for the United States, that the exchange rate is not an argument in the demand for money equation, so you have trouble getting it into there. Now, whether you get an effect from the nature of the flow, I think Mr. Axilrod might say that it would tend to be washed out by the operations of the Desk.

MR. AXILROD. The only thing I would add is that to the degree foreign private investors are less anxious to be in dollars and their dollar holdings that are in the money supply, like overnight Eurodollars, are replaced by foreign government purchases of U.S. Treasury securities--if that's the form of the capital inflow--then, of course, we get minor effects on M2 and M3. But they would be relatively minor, I would think. And they might be replaced by banks getting that money from domestic [sources].

MR. PARTEE. But again, Steve, I want to emphasize Ted's point about nominal income. I think there could be a very marked effect on nominal income mostly through higher prices, and interest rates could move quite a bit if we have a 30 percent drop, say, in the value of the dollar. I think it is a hazard, but it's more indirect than it is verifiable.

CHAIRMAN VOLCKER. Mr. Boykin.

MR. BOYKIN. Mr. Chairman, in the Eleventh District we are seeing the economy very much the way Jim outlined it. If there is a surprise, it is that [economic activity is] coming back a little stronger and probably a little faster than we had originally anticipated. In housing, of course, single-family housing is very strong, particularly in the Dallas/Fort Worth area and that's expected to continue; in multifamily housing, we're probably getting into a dangerously overbuilt situation. Our consumer sales are running along pretty well. In energy there seems to be a turnaround. In Texas, we had a 22 percent increase in rig count last month and in New Mexico a 20 percent increase. Of course, that was from very, very low levels; but there is activity in the oil patch again. In terms of [drilling] permits, in July we had about 2500 permits in Texas and in August we had 10,000. We attribute that to the fact that starting September 1 there was a $100 permit fee to drill a well versus $25, and apparently the people who drill oil wells worry about $75. I'd find it a bit surprising if that would really account for that large an increase. In agriculture, of course, the drought has been mentioned. It's a mixed situation; on balance in agriculture we still might have a fairly good year down our way. I guess it depends on whether you're east of the Pecos or west of the Pecos. Those west of the Pecos, particularly the cattlemen, are having some very, very severe difficulties. I was talking to
and he told me he was taking a thousand head of cattle to market this week because he just didn't feel he could afford to feed them. He said he expected to get about $300 a head and what really upsets him is that when he goes back to restock next year he figures he will be paying $600 a head. I sympathize with him, but then he has 2,000 head east of the Pecos that he thinks he can try to get through the winter. As they say down there in the South: Some people lose a thousand head and the big boys really get hurt. So, we'll see how that turns out.

In talking of the crowding out and whether we are looking past 1984 to 1985, I have a couple of comments I picked up last week: The conversation among home builders, particularly in Texas, is that they are going to be doing all they can for the rest of this year because 1985 is going to be a disaster in home building. That's the type of terminology they were using. Then, I was talking to the president of an electronics firm and he said [business] this year is better than anticipated. Their plans call for a very good 1984, but they don't know how to plan for 1985. They are very, very concerned. So, the overall sentiment seems to be that things are going along well, the economy is coming back, and this will continue through 1984. But the very real question mark seems to be what 1985 is going to be.

CHAIRMAN VOLCKER. Mr. Keehn.

MR. KEEHN. I want to add that I think a recurring theme on capital goods--certainly in the fundamental heavy capital goods industry--in the Middle West is that the situation seems to be very slow. I think the decline is beginning to level out somewhat but at a very, very low level. At this point, there is no discernible improvement. Some of the people who are directly involved in these companies are beginning to think the recovery may pass them by altogether. As people see increasing comments about a recession in '85 and '86, I think there is some concern that they won't actually experience a pickup in the heavy capital goods side. As a consequence, they are beginning to focus on interest rates. Nancy Teeters was in Milwaukee a week or so ago and we heard a lot about interest rates there. I think they really do feel that if we can get rates down, we could sustain a recovery that would bring some improvement on the capital goods side. But that continues to be very slow to move up.

CHAIRMAN VOLCKER. You're not suggesting that we call that "crowding out."

MR. KEEHN. Not quite yet.

CHAIRMAN VOLCKER. Mr. Corrigan.

MR. CORRIGAN. Mr. Chairman, in terms of the economic situation and the commentary that one picks up, at least as you move away from Wall Street and Constitution Avenue, the thing that has struck me most of all in the past month or two is the extent to which the overall international situation has crept into Main Street. Some of that grows out of the LDC debt problem situation and the IMF legislation. It's truly incredible to me how much attention the subject of the IMF legislation gets in places where I would not have expected it. It's quite astonishing. But I think beneath it what perhaps is really going on is the extent to which our trade account, our exports and imports both, really is having a perceptible impact on people in ways that are quite new to them. At our last meeting one of our directors told a story that I think in some way captures this best.

It was quite obvious as he was talking that they have had an informal policy to buy American for a long time. I think he said that they historically have bought everything by way of equipment that they use from an outfit down in your District. They had to replace a single piece of machinery that he described as a $900,000 piece of equipment. They put it out for bid and got the bid back from their customary supplier for $900,000. But they got a bid from a German firm for $500,000. Obviously, the difference between $500,000 and

$900,000 had crossed the threshold point where this outfit could live with their informal buy American policy. If I am reading the tea leaves right, I don't think that situation, while it's obviously just one anecdotal case in point, is unrepresentative of what is going on. Indeed, when you talk about the capital goods industry in the fourth quarter in the Seventh District, I just wonder to what extent this phenomenon at the margin may be making a very, very big difference in terms of what they are seeing versus what they might normally expect to see. And certainly this is also true in the agricultural sector, both in terms of exports of agricultural goods and in terms of imports of agricultural machinery; it's hitting on both sides. I don't know what it means but Karen Horn mentioned it: I do think that it begins to get the smell of a very perceptible but creeping element of protectionism that is now out there in a way that I have not seen it. I don't know what it means beyond that, but it is something clearly different in terms of attitudes and commentary about the economy and the financial system.

On inflation and concessions and all that, I am inclined to the view, at least for the moment, that bankruptcies even when they're quite removed from a particular situation--whether they're in the airline industry or piano manufacturers who have decided to get into the financial business--are still having an effect on wage behavior that's fairly pervasive. But I am not at all sanguine that the wage situation couldn't turn around very quickly in the context of these substantial cash flows and profits that are being generated by the business sector in general. On agricultural prices, the fellows in our Bank who look at that agree with Mr. Kichline that we're looking at [increases of] 7 or 8 percent. Some of our directors who are involved in the agriculture business are on the low side of that. The commentary we get from them rather forcefully suggests that most of the official forecasts, including the Agriculture Department's own forecast, have not adequately taken into account the manner and way in which the PIK program is going to free up very substantial quantities of inventory that have to go into the marketplace. By and large our directors who are involved in agriculture have a more optimistic outlook in terms of the inflation in agricultural prices, although in some cases it may be more pessimistic from their own self interest point of view. Abstracting from this overall international thing, my own view continues to be that in the near term--and by that I mean out, say, to the middle of 1984 anyway--the risks or dangers or whatever you want to call them are on the up side. What that really means in the context of Frank Morris' question--I think he was questioning when crowding out really will become a problem as opposed to the kind of problem it is now--is that it is probably going to be sooner rather than later. And, that's about it.

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. The press has been devoting a great deal of attention to discussing the possible slowdown occurring in the economy. But as we've gone around the table here, I think Jim Kichline and others have captured this very well with regard to the straws in the wind, which leads me to think that this a pretty normal, healthy sort of recovery and one that still doesn't need an undue [effort] on our part to prop it up. It looks as if the recovery is moving into a more mature stage now, and even abstracting from the shortage in automobile inventories and the elimination of some of the sales rebates, I think consumer spending has slowed some and housing has clearly slowed a great deal and probably will slow more. But now we are moving into the stage where I would think that inventory rebuilding and some expansion in capital expenditures would begin to assume part of that role. Really, the only weak thing of any significance that I see in the economy is the export sector. Even that looks a little better in that we have more signs of a pickup abroad now than we had maybe a month or so ago. I think we are in pretty good shape. I do agree with Jerry that there is a growth in protectionism in places we never expected to see, and I share his fear that these wage pressures are going to mount before we expect them to, although they do look darn good at the present time.

CHAIRMAN VOLCKER. Mr. Roberts.

MR. ROBERTS. I don't want to repeat what has been said. I'd like to associate our District viewpoint with the staff view except to say that we think the '84 prospects are probably for a little less real growth and a little more price pressure. I have a couple of comments from our District that might be of interest to you: Auto production is going up very well. Chrysler has added [unintelligible] employees in the last two weeks. Chrysler, Ford, and General Motors are all in the expansion phase of their production in the District. They seem to be very optimistic about future sales potential, particularly for large cars, which is where they have shortages that are affecting their sales at the moment. GM has put an enormous amount of money into a new plant in Wentzville, west of St. Louis, and has yet to produce a car. These are front wheel drive cars and GM is having some difficulty with their quality but they are expected to come on line soon. head of a major independent oil company that he's reasonably sanguine about the outlook for energy prices, even in the face of a probable disruption of supplies from the Middle East, because of the large amount of indicated shut-in production. He said that for the first time there's enough shut-in production outside the Gulf states to offset essentially anything that could happen in the way of reduced supplies from [the Middle East].

I had the principal homebuilders in our area in for lunch recently and they classified themselves as a hardy group of survivors. They certainly were guarded in their optimism and made comments about the distortions in the national figures on home building that really should be related to areas such as Dallas and conceal more difficult marketing problems in mature areas such as St. Louis. But they then went on individually, almost without exception, to speak of their recent land purchases and their plans for expanded building over the balance of this year and next year. They said home prices are up about 6 to 8 percent from a year ago and that, admittedly, there had been some pressures on them a year ago but not a whole lot. They didn't sell much but when they sold something the price hadn't been down. There is concern about rising materials costs, notwithstanding the indicated drop in the cost of lumber; several of them mentioned that the sharply higher cost of lumber was affecting them. Overall, I'd say the expansion continues in our District, but we are getting a few more downs than ups for a while, and the agricultural area remains severely depressed from the effects of the drought.

MR. RICE. Could I just ask why you expect increased pressure on prices?

MR. ROBERTS. Well, I suppose we are concerned about the buildup in liquidity in the economy and the lag effect we expect to be associated with that.

CHAIRMAN VOLCKER. Governor Gramley.

MR. GRAMLEY. Mr. Chairman, there are two things that worry me about the staff forecast. One is that it is so similar to a wide variety of forecasts that exist in the private sector. The staff provided us with the usual summary of forecasts that they follow--Chase, Wharton, DRI and Merrill Lynch--and it's amazing how close everybody is. Real growth next year ranges from 4.2 to 4.7 percent; inflation rates measured by the deflator are somewhat higher than the staff's forecast but are very uniform at a little over 5 percent; everybody expects the unemployment rate to drop to somewhere around 8-1/4 percent by the end of 1984; and interest rates are expected to stay about where they are or maybe go up a little, but certainly not very much by the standards we've seen in recent years. You know, when everybody forecasts the same thing, something is bound to be wrong. There has to be something coming along that we have not foreseen.

The second thing that worries me is that the outlook seems just too good to be true. And if I could lay out the way I want it or what can reasonably be hoped for in terms of a course of economic and financial development next year, what I would hope for is a growth rate that slows down to the range of 4 to 5 percent--enough to make further progress on unemployment and not so rapid a growth rate to generate any unusual inflationary pressures. I'd want a combination of developments that keeps interest rates about where they are or going down a little, pushing off any serious crowding out problem until 1985 and beyond. I've listened to the comments around the table as to which way the risks go, and the sentiment tends to be that the risks may be on the up side. I've asked myself [that question] and I would assess the risks as fairly well balanced. But I would agree that the thing we ought to worry about most from the standpoint of policy is not that we will get a weaker economy but that we will get a stronger one with more inflation. If we get a weaker economy, my feeling would be that we have enough pent up demand for housing and for consumer durable goods that, with a moderate decline in interest rates which certainly would not be unwelcome, we could keep the recovery going. But if we got a considerably stronger recovery and more inflation and began to get significant pressures in credit markets with money growing very rapidly, we would have to resist. Then we would have significant problems. So, really, I hope things work just the way the staff forecasts. But what I worry about most is that the recovery might be stronger with more inflation later on.

MS. TEETERS. I want to go back to Frank Morris' question because I think we are beginning to see some evidence of crowding out and I think we see it in interest rates. The table on page 5 of the [Greenbook] supplement shows that the federal funds rate has gone up 56 basis points since its recent low in May, and the longer-term Treasury securities--the 3-year, 10-year, and 30-year Treasuries--have gone up 2 to 3 times the change in the short-term rates. Then we see the decline of 37 basis points in the fed funds rate since the last

FOMC meeting and almost no decline at all in the rates on longer-term securities. So, I think we're seeing the crowding out in terms of the increase in long-term rates. And those longer-term rates may be crucial to getting the type of recovery that the staff forecasts. That hits housing and it hits capital goods. And it may be that that's what will show up as the crowding out. You also remember that in the July/August refunding the Treasury had quite a bit of trouble selling longer-term issues, and the rates had to go up in order [for the market] to digest those issues. So, I think we're seeing a new form [of crowding out]--one that hasn't been recognized before.

MR. GUFFEY. Thank you, Mr. Chairman. The report in the Tenth District is not unlike others that have been given around the table. That is, retail sales have remained fairly vigorous; the agricultural sector is under some pressure although I would note that in our District it involves only the corn and soybean crops whereas wheat has not been affected since it was harvested before the drought really hit. On the other hand, the PIK program has maintained liquidity within the financial system that finances the agricultural sector. Perhaps the greatest impact would be on those suppliers to the agricultural sector--I'm talking about farm machinery and other manufacturers who are doing no business now and do not expect to into the next year. Energy, mining, and housing, of course, are very much as has been described in other Districts.

I was interested in Governor Gramley's comments because I agree that [the forecast] is almost too good to be true. I disagree only with his last comment in that I think the risks may be on the down side instead of the up side. I too would hate to see a lot of vigor show up in 1984 because it would present the problem that he described. By the same token this forecast seems to me to be largely based upon two or three assumptions: that consumer spending will remain very vigorous; that capital spending will come on very early in 1984; and, lastly, that the dollar will decline and thus improve somewhat the export market and our balance of trade problem. We have seen the saving rate return to the 5 percent level; if that were to continue or go up to some level closer to historical experience, then I assume that consumer retail purchases would be muted somewhat. Similarly, fixed investment may not come on. It appears that there may be a change in the way companies plan their fixed investment. That is, if I understand it correctly, it used to be that we would see fixed capital investment coming on [stream] at a utilization rate in the area of 80 to 85 percent. It seems to me that [business executives] are much more cautious now, having come out of a three-year recessionary experience, and are not going to be as quick to make those capital commitments. Lastly, as to the dollar, the staff--and I think everybody--has been expecting a dollar decline over the last year, and it really hasn't happened. I just note that part of the forecast is based upon agricultural export levels that our people judge will not be achieved either in 1983 or 1984. They are looking at an annual export level of about $36-$37 billion in 1983 and I think the USDA just announced a figure of roughly $34-1/2 billion. Now, that [difference] is not big in magnitude but for 1984 I think the staff is projecting an agricultural export number of about $40 billion and our people think that it likely would be in the $35 billion range or thereabouts. And it is going in the wrong direction, which is one point that I want to make. I like what I see but I would suggest that the risks may be on the down side rather than the up side. I don't think that suggests anything in terms of action by the Federal Open Market Committee at this meeting, but I'm not sure that all is as good as it may appear.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLES. Well, things do seem to be going very well overall. And yet in the spirit in which Lyle Gramley raised the question, I wonder: Is Murphy's law--Murphy's law being that if something can go wrong, it will--going to operate? I travelled around 5 Pacific Basin countries in the last month and one of the questions that kept recurring very frequently--to which, admittedly, I didn't know the answer--was: Are we going to get through this next 12 to 18 months without some sort of a major financial backlash or crisis as a result of the LDC international debt problem? And for those of us who weren't around at the IMF meeting I just wonder, Mr. Chairman, if you or someone else can fill us in on what seems to be the picture with regard especially to the manageability of the international debt position of particular countries south of the border.

CHAIRMAN VOLCKER. Why don't I defer that until we get through this go-around on the business situation, and I'll be glad to address it.

MS. TEETERS. Mr. Chairman, I'd just like to make a comment on the international value of the dollar. I was rather startled yesterday to learn that the forecast has a 15 percent depreciation in the value of the dollar and that depreciation only stabilizes the deficit.

VICE CHAIRMAN SOLOMON. Well, we do get a bigger impact in 1985. It's probably a difference of about $6 billion in 1984, which would be relatively modest. If you make an assumption of a substantially--

MS. TEETERS. What do you mean by "substantially," Tony, 30 percent?

VICE CHAIRMAN SOLOMON. Well, let's say 25 to 30 percent as against 15 percent. I think it would give you only about a $6 billion improvement in 1984 but the improvement is much, much larger in 1985.

MR. PARTEE. Yes.

MR. TRUMAN. Well, as we said yesterday, Governor Teeters, it depends a lot on what you assume as you go out [in time] about how growth is proceeding here and abroad. If we continue with growth here at or above the average rate abroad, which is consistent with many forecasts, then you have to catch up with that. That's basically the reason why that 15 percent depreciation doesn't give us much more than stabilization as we go out. But if we return to a more normal--what one might perceive to be more normal--cyclical position, it would involve probably having faster growth in foreign countries than here. Then we would need less of a further depreciation in order to bring the current account deficit down substantially.

CHAIRMAN VOLCKER. Governor Wallich.

MR. WALLICH. It's hard to make a coherent case one way or the other that differs from the staff position. I would say that the staff forecast differs [from other forecasts] in one significant respect: namely, that it has lower inflation. If it has lower inflation, then given interest rates that are somewhat similar to what other forecasters have, we would have a higher real interest rate. I don't know to what extent that in turn enters into the projection of investment spending. But as for the present level of investment spending, as has been pointed out, it's very bad in the heavy capital goods area. I think overall we can't say that the business fixed investment is bad. On the contrary, it seems to be a little larger than it has been in other expansions. Evidently, there's a great shift in the nature of the investment away from the smoke-stack type goods that one observes in the middle of the country to high technology-type equipment. But secondly, and this was very interesting, maybe the heavy equipment area is additionally hit by the large current account deficit--that is, the weakness in our trade balance which, of course, takes the form of imports of things from abroad that we didn't usually import previously. I think the net export area is really the greatest [source of] weakness in the economy. If we didn't have that, we would have a much stronger expansion. I'm concerned in the same area as Nancy is but maybe about the opposite things. Suppose that the dollar does not go down as projected and as has been projected many times by now. In that case, of course, that gap in the trade balance becomes worse. Now, I agree that we're subject to the possibility of shocks from the developing countries or from wage developments, perhaps incited by large profits. These things are unpredictable. We're getting into the area where professional economists tend to see a lack of demand over the horizon. As far as one can see, things are not too bad. Beyond that, one can't tell what is going to keep the economy going. I would say that this is probably an economic recovery cyclically like all others. If it lasts two years, it would have been short; if it lasts over three years, it would have been very good. And if we cannot see it clearly lasting longer than three years, that would not be a great surprise.

CHAIRMAN VOLCKER. Governor Partee.

MR. PARTEE. Well, I agree with the staff forecast. I think it's very plausible. I usually have something to point out but now that they have the saving rate up some I don't have any complaint at all with it. And it has even occurred to me that the forecast could be right, Lyle. I really don't see anything in the domestic economy that would be terribly upsetting. Possibly something could come out of this Eastern [Airlines] situation and we could get a lot of labor distress and a lot of stoppages in transportation. But that's a long reach. The really different thing about this projection compared to earlier ones is the big trade deficit. I would take it that the trade deficit is our maximum contribution to increasing the prosperity of the world economy because we're importing a lot and not exporting much. And I guess that's what we would want if we see a very weak growth economy. And we certainly do seem to see one. I've been amazed as I read both the New York reports and our own on country developments that there really hasn't been a strengthening around the world as I thought there would be as the summer went on. Indeed, [the world economy] is beginning to look a little weaker.

VICE CHAIRMAN SOLOMON. There's a disproportionately favorable impact on our trade from our large imports from Canada and Japan. There's a relatively small impact on Europe and--

MR. PARTEE. Well, Japan doesn't look particularly strong. And, of course, Canada still has 12-1/2 percent unemployment. So, I just don't see too much there. But I think if something is wrong with the forecast, it's in that area--some result of the very, very unusual trade deficit and the very unusual potential for a drop in the dollar. And that's going to upset the apple cart. I can't say what it is, but that's the area I would refer to as the most problematic.

CHAIRMAN VOLCKER. Do you see these signs of slowing down abroad over the summer?

MR. TRUMAN. We just got a revision in the German industrial production figure, which was adjusted in July. It went down not 0.9 but 2.8 percent. That's a--

MR. PARTEE. Italy, France, and England are often mentioned.

MR. TRUMAN. In the United Kingdom, the action yesterday to drop interest rates by about 1/2 percentage point when their monetary aggregates are above target is interpreted as meaning that they, too, were seeing things weaker than they had hoped. And France and Italy have adjustment problems. So, there's not much over there.

CHAIRMAN VOLCKER. Of course, I've been sitting at meetings with these fellows and they told me for a week how good things were and that they were getting better.

VICE CHAIRMAN SOLOMON. That's the line they've been taking. The Chancellor of the Exchequer told me that he thought [the UK economy] was going to be even better in the second half than in the first half, which most people are saying is not so.

CHAIRMAN VOLCKER. A big increase in the GNP in Germany in the second quarter--

VICE CHAIRMAN SOLOMON. Well, the best one can project, I would assume, would be 2 percent real growth in 1984 for the European community. And it may fall short of that. I think the biggest threat--and I know we'll get into that later--is not the export problem that we're having in our current account deficit but something probably happening in the LDC indebtedness situation that will trigger some major ripple effects around the world.

MR. MARTIN. I'd certainly like to join in that [assessment], Tony. When you look at country after country and what they have agreed to under IMF constraints, in each case one can make the point that they have to solve their own problems--the deficit has to come down, and the subsidies, etc., etc. When one looks across the whole less developed world one wonders how they can increase their exports and how they can slash their imports--not just reduce them but cut them to the bone--and what happens after they cut them to bone. We have this whole section of the planet continuing to operate and jointly [trying to] solve their problems, and it seems to me that inevitably there are going to be great difficulties. And this

Argentina thing is a very political action in appearance but there are great, great possibilities for disturbances arising out of that side of it.

MR. PARTEE. Maybe we need a larger trade deficit.

MR. MARTIN. Maybe we do.

VICE CHAIRMAN SOLOMON. From that point of view we need an easier monetary policy.

MS. TEETERS. That's right. The best thing we can do for them is lower the interest rates.

MR. BALLES. I agree, Pres, and that's why I raised that issue for some discussion here.

MR. MARTIN. When you look at the [projected] increase in our exports from the second quarter to the fourth quarter of 1984, given a 15 percent change [in the value of the dollar] and stipulating all these matters, but assuming that the IMF pattern will work, that we will get the [increase in IMF] quotas, and that we will get the $6 billion and another $7 billion in credits--. The assumptions are cumulative. They simply in my mind do not add up to a world recovery.

CHAIRMAN VOLCKER. Well, that's a pretty strong statement. I was about to say that I was struck by everybody's optimism around the table. Now you tell me there's no world recovery. It seems to me that the business news has been quite mixed recently and everybody is perfectly willing--maybe with your exception--to look through this and say [the economy] is really very good or reasonably good and is going to continue. All the economists who can't see over the horizon are perfectly willing to see out to the next 18 months anyway--at least those around this table--and say that things are going to be fine, or orderly, or whatever. Now, I do think that has a bearing on our current policy decision. I'm not sure that the news is all that uniformly good statistically, but I hear a lot of optimism around the table on balance. And it may be right. I'm not arguing that it's wrong. That's just the conclusion I take from the discussion around the table: Ignore all these soft figures. People are feeling pretty good.

But looking out into the future and questioning what can go wrong, I think a lot of things can go wrong, none of which can be easily incorporated into a forecast of the kind that the staff has to make. I would put this debt problem at the top of the list, and let me return to that. But let me just make a comment about the oil situation, just on the other side of Mr. Roberts' comment. If we really had a disturbance in the Middle East, which people worry about now in terms of the Iraq/Iran war getting more aggressive and involving an impairment of the oil flow from the Gulf area, I think it is true that, looking at the United States position alone, we import relatively little [from Iraq and Iran]. And one could say that if that supply were almost cut off, we could probably make up that gap relatively easily. I don't remember the exact figures but the Middle East still supplies 35 percent of the world's oil or something like that in exports.

MR. TRUMAN. It's a little more than that, probably.

CHAIRMAN VOLCKER. There would be tremendous shortages elsewhere in the world.

VICE CHAIRMAN SOLOMON. And our price--

CHAIRMAN VOLCKER. Activating shut-in capacity or whatever in the United States wouldn't make a dent in that situation and the price impact could be very large if it really happened in a major way. I think this is a completely unpredictable kind of event, but I don't think that we can consider ourselves [unintelligible].

MR. ROBERTS. Paul, I think Bob Sweeney's projection went like this: If Iran and Iraq had no production at all, [the difference] from the decreased levels at which they now operate could be offset by shut-in production. He assumed that the Saudi production would be protected by the United States. That's the big difference here.

CHAIRMAN VOLCKER. Well, that may be if just Iran and Iraq went. That's a big assumption--whether it can be confined to them. I still think there might be a bit of a problem, but you're talking about a more manageable [situation]--not U.S. production, I don't think, but Mexican, Venezuelan, and Nigerian might get through--

VICE CHAIRMAN SOLOMON. And the fighting would spread into the Gulf and straight to--

CHAIRMAN VOLCKER. If they ever reach peace there, we'd probably have a surplus. I guess that's something one can't evaluate. This exchange rate problem and our export problem are all mixed together. As many people have said, it's a new ingredient. I don't know whether to worry more about the exchange rate remaining high or declining precipitously. I think either would give us very real problems. This wage situation is very uncertain in my mind; it depends upon psychology and expectations. I get ultimately buoyed up when I see some figures and ultimately discouraged when I analyze some [other] figures and the lack of any big adjustment, as I suggested earlier, in industries that have not been severely impacted by the recession--the financial industry and the utilities industry to name two. All of these things don't tell me very clearly what policy should be.

But let me return to the debt issue for a moment. The bright spot there, of course, continues to be Mexico. Even there it has to be looked at with some degree of realism, I suppose. Their external financial condition is substantially better. They have a certain amount of cash; they haven't drawn upon all the bank loans they can draw upon. They will be in a position to go back to ask the banks for significantly less money next year, even assuming their imports rise. And they probably will get lower rates in the process. If everything else goes smoothly there, it will probably be a simpler process than it was last year. But at the same time, even looking at Mexico alone, there aren't many signs apparently of an increase in economic activity there. They're still at the bottom in terms of their own domestic business picture and they've had a more severe contraction than the program planned in the first place. It's not unlikely, I suppose, when you begin making a vigorous adjustment that it will go a little further than you estimated. That's part of the reason why they look so much better--fairly dramatically--externally. They have even fewer imports than they were assuming when they took the contractionary measures. Of course, we're feeling the other side of that in our trade picture. But still, I think one could say that they are in a position to [have] some expansion consistent with financial stability if nothing else goes wrong among their neighbors or elsewhere in the world. That prospect isn't exactly safe; we have had Brazil struggling for months and months. And partly because they have been struggling for so many months, I think the political support for a strong adjustment program has deteriorated within Brazil. They had a political setback a few weeks ago when the Congress reared up and rejected a wage law. That is of no substantive significance in itself, but the opposition demonstrated that it could reject the wage law and by implication that they intended to reject the wage law that is the centerpiece of the Brazilian program. Now, that--

MS. TEETERS. How much longer does that have to run?

CHAIRMAN VOLCKER. Well, it has a month-and-a-half or so to run at the maximum. They might do it by avoiding a vote. There may be some maneuvering to have a vote and try to get it passed, but it's a very tenuous situation. Mainly because of that situation, I think the prospect of getting any short-term financing into Brazil has evaporated, and their arrears are getting bigger and bigger; and they have arrears of the kind that will produce nonperforming loans over the third quarter. I don't know if that's any disaster, but it will be an interesting psychological test of the market when banks have to report nonperforming Brazilian loans in some magnitude. On the other hand, we did manage to put together in principle a basic financing program for Brazil if they carry through on their adjustment program. That money wouldn't be available before the end of the year, but in principle the outlines of that--a combination of bank money and public money--are set to go forward. It will not go forward unless they carry through on the adjustment program, and that is very much in question. As I suggested, it may not go forward anyway because we still have a big problem of getting all the banks to join in. The lead banks have agreed in principle; they haven't gotten all the other banks to agree yet. But it's going to remain a quite tenuous situation. Argentina is in a particularly political period before an election. It has been mentioned that they already have taken actions that are inconsistent with their IMF program and it's a question as to how long they can be said to be in compliance with it. The actual specific tests of that program have not yet been violated, looking back, but it's virtually certain that they will be, looking forward. The [situation] has heated up internally in terms of negotiations with the banks to the point that they put the central bank governor in jail yesterday.

VICE CHAIRMAN SOLOMON. That ought to be an IMF compliance standard!

MR. PARTEE. That's an unusual hazard.

CHAIRMAN VOLCKER. It's indicative of the hazards that they run. I don't know [the details]; all I read was a newspaper report that he's too friendly with the foreign banks. But it is some indication of the difficulty of managing these programs.

MS. TEETERS. Didn't a judge down there overturn one of the restructurings?

CHAIRMAN VOLCKER. Well, he made a constitutional ruling against one of the provisions; it had to do with a waiver of sovereignty as I understand. It says Argentina can't do that, and that's a point the banks have insisted upon in these arrangements. And apparently some more particular political incentives are operating on that judge as well. But, it is illustrative of the enormous problems that are both real in the terms that Governor Martin was talking about and political and organizational in terms of the number of people that have to get involved. This, for instance, was a judge in the southern part of Argentina. I don't think it was any great plot, but I think he is in opposition and is a radical fellow who apparently just acted on his own.

VICE CHAIRMAN SOLOMON. Also, Gonzalez del Solar told me that [the judge] acted under the influence of the Argentine Air Force who are very powerful in the Terra del Fuego region where he is located. They are very militantly nationalistic and angry at the United States and Great Britain. Now on the other hand, [unintelligible] told del Solar before he got arrested that they seem to feel that the [unintelligible] Sandinista candidate as well as the radical candidate are both going to play this debt issue very moderately. That was the view as of a week ago. And he certainly didn't get arrested by those groups; he got arrested by--

MR. MARTIN. But look at the risks involved, as we discussed them.

CHAIRMAN VOLCKER. These are not the only countries involved. Some of the medium size countries in Latin America are not in good, though not in terrible shape. Chile, Peru, Equador--none of them is in good shape, but they maintain their equilibrium. Venezuela has been taken care of and an election is coming up, so it should be easier; but there are still very tense political pressures. And there are countries elsewhere in the world, notably the Philippines and Nigeria, that are on the verge of real problems. The Philippines situation is obviously complicated by their political problems on a large scale, quite apart from their economic problems. That makes it very difficult to deal with the economic problems.

The risks [in this country] are at least as large as they have been and in my judgment may be larger. I don't know what the definition of crowding out is, but the only way I can see really important short-term relief--by short term I'm talking about a year or so--would be to have interest rates decidedly lower. The chances of having interest rates decidedly lower with the budget deficits of the magnitude that we are running do not seem self evident to me. Growth obviously is terribly important, but growth acts over a period of years. To get real leverage on their external flows in the short run, interest rates would act over a period of a year if we had a decided reduction in them. Because their debts are so big, Latin America I suppose would get $4 to $5 billion of debt relief if we had a couple percentage points reduction in interest rates. We would not get anything like that from the growth side in that kind of time period. Yet, it is hard to be optimistic that that is going to come about. I see nothing there but their continuing to hang on by their fingernails for the indefinite future. As for these special IMF programs, Governor Martin, I think it is worth saying--IMF or not--that the constraint is the shortage of finance. And if we didn't have an IMF, I suspect they would be involved in even more contractionary programs simply by force of circumstances if they were unable to raise the money abroad. So, it's a risky picture from that side.

VICE CHAIRMAN SOLOMON. There is the view in the world--I'm not sure it would be so at this table--that if a major international financial problem is triggered, let's say, by Brazil or Argentina or something, that the Federal Reserve is basically the lender of last resort in the world. So much of the debt is dollar-denominated that a large part of the world, including France, would look to the Fed to ease monetary policy immediately and very drastically. I'll leave it at that, but I hear that.

MR. PARTEE. Yes, I've heard it too. The foreign--

MR. ROBERTS. Me too. It's very disturbing.

VICE CHAIRMAN SOLOMON. In fact, one very distinguished member of the financial community told me that if Brazil were to announce a standstill or default, whatever you want to call it, that interest rates would immediately fall in the market in New York because everyone would expect that the Fed would have absolutely no alternative but to ease policy.

MR. WALLICH. If countries defaulted on interest, since the interest is more than what they've been borrowing, they would actually be able to import more, assuming that nothing else intervened. Our banks would not get their income and the consequences would be tremendous. But just in terms of what the picture is for them, they feel that they could import more if they stopped borrowing and paying the interest.

MR. MARTIN. From whom?

VICE CHAIRMAN SOLOMON. Yes, but that assumes that they can still get IMF help.

MR. WALLICH. Do you think we'd deny them imports?

MR. MARTIN. I'm asking--

MR. PARTEE. Well, I don't know. How would they get bridge financing for it? And if they move the cash to the United States, wouldn't the banks take it? It would be a very difficult period.

VICE CHAIRMAN SOLOMON. Yes, sure. And the trade credits would stop and a lot of other things would stop. So, I think they'd have a real crisis on the import side.

CHAIRMAN VOLCKER. I think these countries have assumed that it would not be very easy or they wouldn't be trying as hard as they are. Brazil's vulnerability is clearly oil imports. If the oil imports dry up for two weeks, they're out of oil. That's not literally true in the sense that there is a little more stock than that. But considering what has to be kept in the pipeline and so forth, they'd be in real trouble.

MR. MARTIN. And [there would be problems in] the flow of foodstuff and spare parts after a period in which the inflow of foodstuff and spare parts has been down. They already have cut their imports. Add on to that a difficulty of importing--

GOVERNOR WALLICH. I tell them that too because I have to make a case. I just want to say to you that the case is not very convincing.

CHAIRMAN VOLCKER. Not very convincing to whom?

MR. WALLICH. It's not very convincing to them that they would not in some sense be better off if they defaulted. They will have tremendous difficulties. They'd be sued; they'd be taken to court; planes and ships would be attached. Whether it would really become impossible to import, I don't know.

CHAIRMAN VOLCKER. I don't know either. But so far, they have not been willing to take the chance. That's what you can say. So far as the rest of the IMF meeting is concerned, let me say that there has been a lot of stuff in the newspapers. The tone, from where I saw it--and maybe I didn't see it all--was reasonably good. The United States took what was considered to be a very tough line specifically on some of these IMF issues. A lot of the rest of the world didn't like it much and certainly some of the developing countries didn't like it much. But there was a tendency to say that we had to do that because of the IMF legislation, so we got excused for a lot of things we ordinarily wouldn't be excused for, I suspect. There was a feeling, which I don't think is entirely true, that it was politically necessary in the United States. The people were quite happy that the President very strongly supported the IMF legislation in a very uncompromising way publicly--more strongly than he had before in a public statement of this sort. That was accepted at face value and thought to be very, very encouraging. There was a great deal of worry about whether we will in fact vote for the IMF package in the end and a lot of concern as to what would happen if that fails.

MS. TEETERS. But he hasn't signed the letter?

CHAIRMAN VOLCKER. He's presumably negotiating that letter. I don't know whether he will send it or not.

VICE CHAIRMAN SOLOMON. Send this to the--

MS. TEETERS. Seventy.

VICE CHAIRMAN SOLOMON. Seventy?

MS. TEETERS. Seventy times.

CHAIRMAN VOLCKER. How long are you going to talk, Mr. Axilrod?

MR. AXILROD. 15 to 20 minutes on this special presentation.

CHAIRMAN VOLCKER. We'll let you talk for 15 to 20 minutes and then we'll have coffee.

MR. AXILROD. There's a package of material--charts on velocity, in which chart 1 is the M1 velocity--and I'll be referring to those charts. I'll be giving a special presentation on velocity without necessarily any implications for current policy. Mr. Chairman, I have no more than a very few comments on current policy, but I would delay making them if I--

CHAIRMAN VOLCKER. I don't know what order you're going in. You're going to talk about velocity first and then current policy second?

MR. AXILROD. Yes, on velocity for around 15 to 20 minutes.

CHAIRMAN VOLCKER. All right.

MR. AXILROD. [Statement--see Appendix.]

MR. PARTEE. Satisfied?

CHAIRMAN VOLCKER. I have a question. These velocities on chart 8 look a little different--maybe it's a difference in scale--than those on chart 1. Are they computed differently?

MR. AXILROD. No, I do have a lag in the middle panel on chart 1 and there is a scaling difference and they start in 1969.

CHAIRMAN VOLCKER. Chart 1 isn't lagged, is it?

MR. AXILROD. No, I don't have the lags in chart 1.

CHAIRMAN VOLCKER. But it's on a four-quarter basis?

MR. AXILROD. Yes.

CHAIRMAN VOLCKER. Four quarters on--

MR. AXILROD. No, they're both quarterly. They should be exactly the same except that it's lagged on one chart and contemporaneous on the other and I shortened the time period and put M2 and M3 down for reference.

MR. BLACK. The scales are a lot different.

MR. AXILROD. There is a difference in scale but there should be no difference in the numbers.

MR. BALLES. Mr. Chairman, I have a great respect for Steve's analysis. In fact, his report was so interesting that I wish to ask him if he would provide us with a copy of it so that we can study and digest it. Until I've had a chance to do that, I wouldn't want to make any immediate response or rejoinder other than to say that his conclusions leave us with a considerable dilemma. The bottom line on his conclusion--that it's premature to place much more weight on M1 at this time--is somewhat contrary to the paper that I distributed following our last FOMC meeting. The dilemma that I see is that the Board staff's response to our paper, which has not been circulated to the rest of you yet, pretty much agreed with the second major proposition in the paper that I distributed. Here's a quote from a paper from Steve that was prepared [by Board staff] and had to do with the fact that there is no discernible relationship in recent years between M2 and M3 on the one hand and future income on the other: "Indeed, there does not appear to be any significant statistical relationship between M2 and nominal GNP." So, perhaps it's appropriate to be cautious about saying that we can restore faith in M1 or put it up higher in priority in terms of our goals. But at the same time, let's not overlook the fact that we've been dealing with two other intermediate targets, M2 and M3, and putting more weight on those for quite a few months now. And I think all of us knew, or should have known, that there was darn little relationship between those two particular intermediate targets and the rest of the economy. So, M1 may be far from perfect but the alternatives are even worse. And that's the dilemma. Pending the chance to really cogitate and think about Steve's paper, I'd prefer to defer any other comments or rejoinder until I've had a chance to do that. But I congratulate him on the excellent work that he's done here.

MR. AXILROD. Mr. Chairman, may I make a comment? President Balles did refer to a staff paper which actually had been sent, of course, to your staff in the spirit of professional economic discussion. The bulk of it was the technical analysis of the econometric methods used in the estimating procedures. There was a small part of it in which the people went on to provide some tests about whether M1 or M2 would be better. I would not read those results--and I'm not sure that that paper would be circulated in exactly this way to the FOMC--as indicating in any way that M1 was good over the last year and a half. The part that you were referring to was a set of theoretical, not empirical, estimates of various kinds of elasticities and what one would have to have for M1 relative to M2 for M2 to be better. I think the econometric evidence that I referred to here does show that the prediction values of M2 and M3 were no better than M1 in predicting GNP in 1982. In 1983, from some perspectives perhaps it was a little better; it turned out quite well, maybe by accident, because on average M2 and M3 don't do as well as M1. But M2 didn't miss the first-quarter and second-quarter predictions by [much]; on average, it was less than 1 percent at an annual rate. The [predictions] went far off in the third quarter because of the first-quarter distortion in M2. So, I think it's quite right that M2 and M3 didn't become better as M1 got worse, but they didn't get nearly as bad as M1 relative to their past experience in this particular period. This is a transition period.

MR. BALLES. Well, if I may: I think we probably both agree, Steve--if you don't, say so--that the main reason for the precipitous drop in M1 velocity in '82 and the first part of '83 was a parallel decline that took place in both inflation and hence in interest rates. And bottom line, our expectation is--and admittedly this is a forecast and not yet a fact--that the slight improvement that we've seen in M1 velocity in the second and third quarters is about to become more than slight as we go into the fourth quarter. In fact, our forecast for M1 velocity in the fourth quarter is about a 4 percent increase. If we're right, and time will tell, we are really on the verge of M1 bouncing back to a point where it can be used and would be superior to M2 and M3. But, as I say, that remains to be seen.

MR. WALLICH. I find it difficult to rely on velocity as a measure of the usefulness of an aggregate because if velocity is variable but determined by factors that can be measured in relation to it, principally interest rates, then the demand function for that aggregate will be stable even though velocity is not. And it seems to me that we have to factor that in before we judge the aggregates. The demand function I guess is pretty standard in the profession but has lately been buried among researchers. And I think efforts should be directed toward getting a better grip on what is the right money demand function than on the stability of velocity.

MR. BALLES. I would agree with that, Governor Wallich. In fact, one of the main thrusts of the paper that I distributed was that, in our view at least, demand for M1 has not been unstable in recent times--that what we witnessed in '82 and in the first part of '83 was not a shift in the demand for money but a movement along a given demand function as interest rates came down and people wanted more money. That's not the same as a shift in the demand for money; that's moving along a demand function. And therein, I guess, lies one of the differences in analysis between us and Steve.

MR. AXILROD. Well, I think M1 demand may be highly interest sensitive at this point. The alternative estimating methods can give you somewhat different results over the long run than obtained in your excellent staff paper. I wouldn't doubt that in this transition period M1 elasticity is a lot bigger because I think the NOW accounts have introduced that because of the ceiling rates and the related movement of market rates and ceiling rates. So, it appears we have that. The main point I was trying to make for the Committee was that if indeed it is true that the M1 demand is highly interest elastic--and I don't think it is over the long run though I think it may be now--to the degree that's true the value of M1 as a target, even if you can predict the demand, is reduced. It is not such a good target for you any more.

CHAIRMAN VOLCKER. [Unintelligible.]

MR. AXILROD. Then, when interest rates go down, because the economy is weaker than you have projected, you have to let money grow a lot faster than your target. So, it isn't serving the function of a fixed target.

CHAIRMAN VOLCKER. You're back to targeting interest rates?

MR. AXILROD. Right. Intuitively, if there was no interest elasticity to money demand and income was weak, then you could hold this fixed target and income would be dragged back up. There would be a lot of interest rate variation. That gets to be the problem if money is as highly interest elastic as your paper makes out.

MR. BALLES. Well, one of the things that I found fascinating about the technical paper that was distributed was that the Board's staff found fault with the way we had computed interest elasticity going back to the mid-1960s, but there seemed to be no disagreement in the two methods that your staff used leading toward a conclusion that interest elasticity had shown virtually no change. The interest elasticity of M1 has shown virtually no change following the introduction of NOW accounts in January of '81 and Super NOW accounts in January of '83. I was quite impressed by those flat lines. That was one of the things that we had concluded: that the introduction of NOWs changed interest elasticity.

MR. AXILROD. I think there are some technical disputes.

CHAIRMAN VOLCKER. I think you have some disagreement there. Do you have 2 minutes on current policy, Mr. Axilrod?

MR. AXILROD. Well, Mr. Chairman, it's very brief since the aggregates are so comfortably within their ranges. We really had a hard time thinking of alternatives for the Committee to consider. Alternative B, of course, was based on current reserve conditions, which we've interpreted as borrowing centered around $650 million, and an associated funds rate probably around 9-1/4 to 9-1/2 percent. Alternatives A and C are somewhat easier and somewhat tighter, respectively. But even so, the degree of ease and tightening as presented there is not so much as to push the aggregates outside their long-run ranges; M1, M2, and M3 remain within the ranges from now to the end of the year. The logic of presenting alternatives within our usual structure--where aiming at a higher money growth leads to lower interest rates and a lower money growth to higher interest rates--to my mind yields somewhat anomalous results under current circumstances unless there are vast differences in opinion about the staff outlook for the economy or about the demand for money. For instance, given the economic outlook, there is no apparent need to force money up or down in the ranges by significant changes--at least premeditated or fore-ordained changes--in reserve restraint or reserve paths. The question would seem to be more whether if money were moving up in the range, or even above it, the Committee would wish to tighten. And if money were moving down, would the Committee wish to ease and to what extent? It's somewhat opposite from the way the specs are presented and the logic of it. Given as much uncertainty as still prevails about the meaning of the aggregates that are the focus of policy, it seems to me that the answer to the policy question still involves an assessment of the economy and emerging financial conditions. Thus, the directive as structured at the last two meetings, with a sentence that in effect serves as a proviso--permitting reserve adjustments to faster or slower money growth depending on the economic outlook and financial conditions--seems appropriate assuming that whatever option is adopted is an option that keeps money growth comfortably within the range.

CHAIRMAN VOLCKER. With that I think we ought to have a doughnut.

[Coffee break]

CHAIRMAN VOLCKER. You all heard Mr. Axilrod's opinion that the real question is what to do if these various aggregates begin going off track. The implication is that there isn't much to do at the moment. Although he didn't say it explicitly, I suppose that suggests some version of alternative B, which he interprets as no change for the moment, assuming nothing goes off track. I will raise that question anyway, as to whether that's a reasonable starting point.

MR. ROBERTS. Mr. Chairman, I think that's a very good starting point and I would recommend that we pursue that path. My only concern would be that we not let the growth of the aggregates diminish from these suggested rates in October through December, which are well above where we've been recently.

MR. PARTEE. I think that's probably the question isn't it, Paul--whether they are going to snap back in the way projected?

CHAIRMAN VOLCKER. Well, I don't think we know. That's what Steve was saying: We have to get some guidance on what happens if indeed [monetary] growth either snaps back and goes above or goes below. Presumably, there would be some implication for moving and the rate of speed at which to move. How aggressively to move is a nice question. If we start where we are, which is at this peculiar $650 million borrowing level that we talk about but which has never been in existence--

MR. AXILROD. In the past three weeks.

MR. PARTEE. The fundamental borrowing level.

CHAIRMAN VOLCKER. What is going on in the market today, by the way?

MR. STERNLIGHT. The funds rate is firm at 9-1/2 or 9-5/8 percent--a slight improvement.

CHAIRMAN VOLCKER. You're on track with $650 million now?

MR. STERNLIGHT. Borrowings have been running closer to $1 billion this week. Banks may want more excess reserves than we're allowing for. Our projection has us slightly above the [reserve] path, which is staying put, and getting some RP withdrawal that will put us closer back to the path.

MR. BLACK. Mr. Chairman, we had $647 million one week; and that was the week before we went to a $650 million [objective].

CHAIRMAN VOLCKER. That's the week before we went?

MR. BLACK. That's right.

CHAIRMAN VOLCKER. Well, I don't want to speed you along faster than you want to go, but are we starting roughly where we are?

MR. BOEHNE. May I ask a question about where we are? I understand the $650 million; I think I understand why we shoot at $650 million but don't hit it. But are we talking in terms of a federal funds rate of 9-1/4 percent as being what we think is roughly consistent with $650 million of borrowing or are we thinking of 9-1/2 percent as being consistent with it, or what?

CHAIRMAN VOLCKER. Well, 9-1/4 percent is what Mr. Axilrod says, but I don't consider that a vital part of the decision. I don't know exactly what [funds rate] is consistent with it down to the last quarter point.

MR. AXILROD. Borrowing since the last Committee meeting, as we said, varied between $650 million and $1.6 billion. And for practically all of that time the funds rate on a weekly average basis was within 5 or 6 basis points of 9-1/2 percent. Then one week it dropped to a little over 9 percent. So, the relationship has been quite loose.

CHAIRMAN VOLCKER. I think the best answer I could give to your question is that $650 million implemented over a period of time, with a reasonable excess reserve figure, would probably give you a federal funds rate averaging less than it has been averaging.

MR. PARTEE. A little less.

CHAIRMAN VOLCKER. Somewhat less; how much less I don't know.

MR. BLACK. I liked your starting position better than the one you moved to subsequently, Mr. Chairman.

MR. RICE. Did it change?

CHAIRMAN VOLCKER. I'm not aware that it changed.

MR. BLACK. I thought it did--just a tad, it seemed to me.

CHAIRMAN VOLCKER. I'm talking about $650 million borrowing and using the specifications of alternative B.

MR. PARTEE. That sounds fine to me.

MR. RICE. Me too.

MR. BOEHNE. It seems to me that the risks are probably more on the side of continued undershoots just because, looking back over this, if we get a string of undershoots we usually get them in a row; and if we get overshoots, we get overshoots in a row. It seems to me that we're more in the midst of a string of undershoots so, for no intellectual reason at all, my gut tells me that we probably have a little more chance for continued undershoots than we do overshoots.

MR. PARTEE. The trouble with that is the undershoots end sometime.

MR. BOEHNE. They do end sometime.

CHAIRMAN VOLCKER. Well, I have no particular feeling on that one way or the other. But I do feel we have to discuss how we will react to either undershoots or overshoots. I'm only in stage one.

MR. BOEHNE. My sense is that if we continue to get weakness, we ought to probe down with the borrowing. I don't have a problem with that. I would have a problem, however, if we suddenly got a lot of strength; I would not automatically want to probe up.

CHAIRMAN VOLCKER. I think you're just a little ahead of the game. Let me come back to you and ask my original question: Do we want to deal with those questions that you're dealing with against the starting point of basically $650 million of borrowing?

VICE CHAIRMAN SOLOMON. I think that's the only thing to do.

CHAIRMAN VOLCKER. Well, that seems to represent the general feeling. Okay, Mr. Boehne, go ahead. Did you say if monetary growth falls short [of expectations], you want to react pretty quickly and if it goes above, you want to react more slowly?

MR. BOEHNE. That's basically right.

MR. PARTEE. I don't agree with that. I would be evenhanded and I would react to an appreciable change in the aggregates in either direction.

MR. GRAMLEY. Well, I'd want to be evenhanded but I would want to try and interpret [the aggregates] in light of what was happening in the economy. If I saw a weak money number for October prospectively and a very strong set of September employment statistics, then I'd relax and let that happen. If, on the other hand, the money growth were strong in October and the September employment statistics came in very weak, then I'd want to go in the other direction. But I'd want to have a lot of input from thinking of where the economy is going.

MR. MARTIN. I think the fragility of the world debt situation is such that probing downward makes sense. I think that is the major risk to our recovery on a three-year basis; it's a major risk to the world's recovery; and it's a major risk to the financial institutions, particularly the commercial banking institutions in this country in terms of write-offs and their possible contraction of credit in a different sense than we use that term. Therefore, I would be very cautious in probing upward and quite willing to probe down.

CHAIRMAN VOLCKER. Let me just mention a descriptive point that bothers me a little, but it's going to be dealt with in the policy record. If we do begin as we just said--that we remain basically unchanged--presumably the directive will say we remain unchanged. The last directive said we remained unchanged. In theory, we have eased a shade since the last meeting but both directives say things are unchanged.

MS. TEETERS. But we haven't--

CHAIRMAN VOLCKER. It all would be clear enough if the borrowings actually had been lower recently, but in fact they weren't. So we're saying we are remaining unchanged in a somewhat easier posture that isn't evident--

MR. PARTEE. And may become so.

CHAIRMAN VOLCKER. --to anybody who is not inside our heads. How do we explain this in the policy record?

MR. BOEHNE. Well, we have to do the borrowings. We could say something like "taking into account the somewhat lower reserve conditions." We would say about where that level is.

CHAIRMAN VOLCKER. What level? The trouble is the last figures right up to this meeting are higher in terms of borrowing.

MS. TEETERS. We average them.

CHAIRMAN VOLCKER. Well, we say reserve conditions. I don't present this as a major substantive point; it's just a little something that has to be cleared up, and it's a little difficult because they--

SPEAKER(?) How about "maintain the somewhat easier tone."

MR. RICE. But it's within the tolerance limits of unchanged. That's [conveying] the point that we can still say unchanged even though there has been substantial--

CHAIRMAN VOLCKER. I'm not saying there is a substantive problem but I think there is a completeness-of-the-record problem. We have gone from--it wasn't much of a change--$800 million or something in borrowings in our minds to $650 million and it's all labeled as unchanged. And, in fact, the statistics went from $800 million to $1 billion in the last--

MR. BALLES. Weren't there a lot of quarter-end pressures in that?

CHAIRMAN VOLCKER. I know why it happened. All I'm saying is that some clever writing--not clever in the pejorative sense--

VICE CHAIRMAN SOLOMON. John Berry's article in The Washington Post, I think, goes in that direction. He quotes from the directive and says that the flexibility of how the Desk interprets "maintaining the existing degree of restraint" is becoming enormously wide.

MR. PARTEE. He neglected the fact that the Desk checks with the Chairman.

MS. TEETERS. No, he didn't.

VICE CHAIRMAN SOLOMON. Oh, it came through pretty clearly.

MS. TEETERS. But can we use the words "decrease slightly"? If we got to $650 million, we would be down almost $300 million in the borrowing average for the month.

CHAIRMAN VOLCKER. We could say that, but that's a little misleading too in terms of our--

MR. PARTEE. How about "maintain a slightly easier posture with respect..."

CHAIRMAN VOLCKER. The nice thing to say would be "seeks to maintain the slightly easier posture implemented over recent weeks," but it wasn't implemented.

MR. BALLES. How about "intended for recent weeks"?

CHAIRMAN VOLCKER. That's exactly what it is: maintain the slightly easier posture intended but not implemented.

MR. GRAMLEY. Well, we're quibbling about words now.

CHAIRMAN VOLCKER. I didn't--

MR. GRAMLEY. I understand. In terms of the way this should hit the public later on, I think we'd be much better off if we said unchanged and then--

CHAIRMAN VOLCKER. Well, I just raised this because I think it needs some description in the policy record. It would not be in the directive itself unless somebody can think of very clever wording for the directive.

But I diverted us from this other discussion. What I have are some views that if things come in weaker, we ease a little, if it's quite natural on the aggregates. And if things come in tighter we would be either reluctant or we'd be symmetrical, all depending upon the business situation.

MR. MARTIN. And the international situation.

MS. TEETERS. Well, I happen to be depressed about the international situation; I think it has gotten increasingly fragile in the past couple of months. And the best thing we can do for them is to get lower interest rates. If we have the opportunity to lower them, I think we should do it. So, I would probe downward as much as possible and be reluctant to raise the rates.

MR. KEEHN. We do have a meeting next month and one wonders whether anything is going to happen between now and then that we have to worry too much about.

VICE CHAIRMAN SOLOMON. Well, if we continue operating as we did here, there is a certain degree to which the Chairman and the Desk and Steve are exercising a bit of discretion.

CHAIRMAN VOLCKER. All this is simple enough unless the business news diverges from the monetary aggregates news. If we have the kind of thing Lyle was talking about, all the [business] numbers would be coming in quite buoyantly but the monetary numbers could remain low for another month and we might be quite happy about that and not want to do anything. If the business news is mixed or weak and the aggregates are low, it's quite clear what we do; and vice versa, it's quite clear what we do. If we get these mixed signals from the two sides, it's a little more difficult.

MR. MORRIS. Then you could handle that in a conference call. We could make a directive based on an existing understanding that if we get the kind of--

CHAIRMAN VOLCKER. We can't deal with every possible contingency here. We can have a call, but we can get some feel for the situation anyway.

MR. GUFFEY. It's not meaningful, I think, for this short intermeeting period but how would the markets read this directive if we say "maintain the existing degree of restraint" and have the accompanying language for [moving] up and down [from that], when they see after the next meeting that the quarterly targets at least for M2 and M3 were raised at this particular meeting and [we say] nothing happened.

CHAIRMAN VOLCKER. Have they?

MR. GUFFEY. Well, they won't--

CHAIRMAN VOLCKER. The numbers we would put in here, I suppose--. Oh, the 1/2 percentage point [difference]. Suppose instead of saying 8-1/2 and 8-3/4 percent, we just say 8-1/2 percent [for M2 and M3] and 7 percent [for M1].

MR. GUFFEY. Well, to be sure, the two have gone up only 1/2 percentage point from the third quarter to the fourth quarter.

CHAIRMAN VOLCKER. They're up 1/2 percentage point.

MR. GUFFEY. But it [represents] some ease. My question, and maybe somebody can answer it, is: How would the market interpret that 30 days from now?

MR. AXILROD. The October 1st deregulation is enough almost to explain a 1/2 point, I would think.

CHAIRMAN VOLCKER. I don't think they would pay any attention to a 1/2 point [difference].

VICE CHAIRMAN SOLOMON. What they will pay more attention to is if they see the fed funds rate decline to below 9 percent in this period and then they see the release of a record that says "maintain the existing degree of reserve restraint." Then they would be surprised, possibly.

CHAIRMAN VOLCKER. No, if the money supply were low, I think they would say: Okay, you said if the money supply came in low, you'd ease a little.

VICE CHAIRMAN SOLOMON. But if the money supply were still within the target but in the upper half, then I'm not sure they would understand that we were not being a little more secretive in easing. But I don't think it's a major point.

MR. PARTEE. Well, the staff projects pretty strong growth in the money supply; I wouldn't think it likely that the funds rate would drop by much. In both the market and the net borrowings, it seems to me to--

MS. TEETERS. Well, it depends on velocity.

VICE CHAIRMAN SOLOMON. If the real economy were showing signs of weakening, even though the money supply was still in the upper half but within the range, it might still be a situation where we would do some easing. That's a mixed case.

MR. PARTEE. That's even another combination--high money and a low economy.

VICE CHAIRMAN SOLOMON. It's not likely.

CHAIRMAN VOLCKER. The more I look at that first sentence the more it bothers me in terms of being misleading. I'm afraid the more accurate thing to say would be "The Committee seeks in the short run to decrease slightly the degree of reserve restraint evident in the market in recent weeks."

MS. TEETERS. Yes, that's the record.

MR. MORRIS. Why not?

MR. GRAMLEY. Right. When you say "reserve restraint" are you talking about the funds rate or are you talking about net borrowed reserves or borrowings?

CHAIRMAN VOLCKER. Net borrowed reserves or the borrowings.

MR. GRAMLEY. It seems to me if we put out a directive--

CHAIRMAN VOLCKER. We did have one whole week where net borrowed reserves came in less.

MS. TEETERS. The month averages out as $450 million.

MR. STERNLIGHT. There were three recent weeks when the borrowing was about $700 million.

MR. AXILROD. The lowest week was way back on September 9th when we had virtually--

CHAIRMAN VOLCKER. Well, let me look at these figures. Maybe it's not as bad as I thought it was. What are they? Read off the recent borrowings and the net borrowed figures.

MR. AXILROD. Adjustment plus seasonal borrowing for the August 24th week, which was the week of the meeting, was $1.1 billion; August 31st it was $1.2 billion. Then it was $757 million, $647 million, $1,589 million or $1.6 billion, and then this past week $739 million. And this week they're probably going to be somewhere around $800 or $850 million.

CHAIRMAN VOLCKER. All right. Now, what was [net borrowed]?

MR. AXILROD. The net borrowings, doing quick subtraction in my head, would be: $600 million August 24th; around $700 million August 31st; then close to zero; around $220 million; $1.3 billion; and last week $317 million.

CHAIRMAN VOLCKER. And this week it should be what?

MR. AXILROD. Now, the market takes out the seasonal though. This week?

CHAIRMAN VOLCKER. $300 million or so.

MR. AXILROD. This week we're aiming at $200 million. Yes, it's $450 million and $650 million, so probably we're very close to $200 million. We may hit it with higher borrowing or higher excess.

CHAIRMAN VOLCKER. Well, maybe that's not so bad. If you take out that one figure and give weight to net borrowed reserves, we have been distinctly lower than we were. I don't know when we were--

MS. TEETERS. But take the monthly nets. It was +10 in May; -200 in June; -370 in July; -609 in August; and about -450 in September.

CHAIRMAN VOLCKER. Well, it's one month. But I guess we could almost say "The Committee seeks in the short run to maintain the slightly lesser degree of reserve restraint achieved in recent weeks" if [the numbers] come out [as expected] this week. We had two weeks, then, of a low net borrowed figure.

MR. AXILROD. The other fact, Mr. Chairman, is that in July nonborrowed reserves dropped about 0.3 percent and dropped 9 percent [in August]. In September, based on the data as of the end of last week, they will rise around 4 percent because there's a small drop in borrowing. So, the nonborrowed is turning up in September after dropping.

MR. STERNLIGHT. I think it's "sought in recent weeks."

MR. GUFFEY. I think that's right. Can we use the word "sought" in recent weeks instead of "achieved"? That's exactly right; everything else would--

CHAIRMAN VOLCKER. Well, maybe we just say that and explain it in the [policy record].

MR. STERNLIGHT. The policy record can refer to the difficulties with the Treasury balances.

MR. AXILROD. Well, you could say "the slight easing in reserve positions" and point to the nonborrowed going up as was reflected mainly in drops in short rates other than the funds rate, which was affected by all these other things. Because the other short rates are down.

CHAIRMAN VOLCKER. Well, except right now as we're meeting the funds rate is quite high.

MR. AXILROD. No, I mean it was reflected in other short rates apart from the funds rates.

MR. MARTIN. Now we're talking about rates.

CHAIRMAN VOLCKER. Then we say we're aiming at those rates?

MR. AXILROD. No, I meant the easing in reserve conditions was reflected--

MR. GRAMLEY. I can't imagine that market participants would look at numbers like net borrowed reserves, borrowings, and the funds rate and decide that what we've been trying to do is to hit a target for net borrowed reserves. The numbers are all over the map, as are the borrowing figures. They saw the funds rate average 9.4, 9.4, 9.5, 9.5, 9.5, and 9.0 percent [in recent weeks]. And to say that market participants are going to look at what we say and then compare it with the borrowing numbers seems to me a little strange.

CHAIRMAN VOLCKER. Really, I'm not sure what you're saying. That one week screwed it up. Otherwise the borrowing number and the net borrowed both are distinctly lower than they were earlier.

MR. GRAMLEY. Yes, but they're all over the map. The range runs from $647 million to $1.6 billion on borrowings. And for net borrowed reserves it's from 0 to $1.3 billion.

CHAIRMAN VOLCKER. Yes, that one week--

MR. GRAMLEY. Well, it isn't just one week. Throw out that one week and now the range on borrowings goes from $647 million to $1.2 billion and on net borrowed reserves from 0 to $700 million.

CHAIRMAN VOLCKER. The $1.2 billion goes back to the earlier period; that's before we moved. In the last five weeks there's only one week that's way out of line.

MS. TEETERS. Well, the net borrowed on a monthly basis reflects what we've done, if you average out the weeks.

VICE CHAIRMAN SOLOMON. Could we put it this way? Could we say: "The Committee seeks to maintain the existing degree of reserve restraint, compatible with the slight easing in market conditions in recent weeks."

MR. MARTIN. That "compatible with" sounds like rate targeting.

VICE CHAIRMAN SOLOMON. Because we have seen some easing in market conditions.

CHAIRMAN VOLCKER. Yes, but I think the problem--

MR. PARTEE. I like the word "maintain" and I like the words "slightly easier." Any connective that makes it possible--

MR. RICE. Anything that makes those reconcilable is all right with him!

CHAIRMAN VOLCKER. What we have written down here at the moment is: "The Committee seeks in the short run to maintain the slightly lesser degree of reserve restraint sought in recent weeks."

MR. BLACK. Should I put that down or will you change it?

MR. WALLICH. Then we have to explain how we came to seek a different one than we said in the previous directive.

CHAIRMAN VOLCKER. I think what we've done is distinctly compatible with the previous directive, but I--

MR. PARTEE. Yes, because it's consistent with weak aggregates in the light of business conditions.

MR. GRAMLEY. Mr. Chairman, should we heed the Biblical passage "Seek and ye shall find"?

CHAIRMAN VOLCKER. Eventually. [This wording] isn't perfect, but then--

VICE CHAIRMAN SOLOMON. [Unintelligible] other interest rates in the markets generally, so why can't someone try to explain why--

CHAIRMAN VOLCKER. I think by implication you're saying we are aiming at interest rates.

MR. MARTIN. Mention rates and they think we're targeting rates. Mention M1 rebasing and they think we're targeting M1.

MS. TEETERS. Well, we've mentioned enough different things in that length of time.

MR. BLACK. They might think it means the discount rate.

CHAIRMAN VOLCKER. Anything we put in there is going to require some explanation.

MR. GUFFEY. But the policy record can explain that.

MR. PARTEE. Sure.

MR. GUFFEY. Really, it's not--

CHAIRMAN VOLCKER. Unless there's strong objection--I don't think we're talking about any substance in what we're trying to do here--I'll put in this language: "The Committee seeks in the short run to maintain the slightly lesser degree of reserve restraint sought in recent weeks." We'll explain in the policy record that we had problems with Treasury balances and the market was a little easier.

MR. GUFFEY. That's also consistent with what we would have done because of the way the aggregates came in from the--

CHAIRMAN VOLCKER. Yes, I don't think there's any trouble in rationalizing it with the previous directive.

MR. AXILROD. There will be indicators of somewhat lesser reserve pressures on the net borrowed--

CHAIRMAN VOLCKER. It is except for that one week.

MR. AXILROD. Yes, if we look at September and August on average, net borrowed is a little less than--

CHAIRMAN VOLCKER. Okay. Who can add some enlightenment as to how we should react to contingencies?

MR. BLACK. I'll just say symmetrically, Mr. Chairman.

MR. BALLES. Paul, I'd like to support the proposition made by Governor Martin a little while ago that if we have a chance to probe toward a little lower rates, we should do so for the reasons he set forth, which I find not only cogent but very worrisome.

MR. CORRIGAN. There's a Catch-22 here, though. My concern, as I said before, is that, if anything, the economy may be stronger than the forecast and then inflation might be greater than the forecast. I think that way because in some ways the focus now should be 1984 rather than just the fourth quarter of 1983. Personally, I would be happier if we came out someplace closer to between "C" and "B" rather than "B." I think the Catch-22 is very important because if the economy is stronger and inflationary pressures are greater, then we get Frank Morris' collision sooner rather than later. And if that happens, we will not have helped the LDC problems; as a matter of fact, it works the other way. I get troubled by this whole argument that says that the solution to the LDC debt problem is [for us] to ease monetary policy. The real solution is beyond our control: It's a tighter fiscal policy. But I think there is some danger in overplaying that and ending up with just the results that we're trying to avoid.

CHAIRMAN VOLCKER. I agree with that to the extent that if we get too aggressive--and we're talking in a limited range here, I understand--and take too many risks of having the aggregates and the economy moving up on us, it may help to bring a little glimmer of hope to the LDCs for three weeks, but then we will put an arrow through their hearts.

MR. PARTEE. You know, Paul, I think this language in the next sentence is just perfect.

CHAIRMAN VOLCKER. Oh, I think the language covers it all right.

MR. PARTEE. The language, you notice, does not qualify less restraint but it does qualify more restraint by saying "somewhat" more restraint. And I think maybe that's a reasonable compromise.

CHAIRMAN VOLCKER. I don't have any trouble with the language. I agree that the language in its general way covers what we're talking about. But it doesn't mention the international situation explicitly. I don't know whether that's wise anyway.

MR. PARTEE. I don't either.

MR. BALLES. Mr. Chairman, this dialogue here--

CHAIRMAN VOLCKER. There is the phrase "other factors bearing on the business and inflation outlook."

MR. BALLES. Mr. Chairman, in terms of whether we probe one way or another, it is at least my sense that we would be probing toward a little lower rates only on the condition that the Ms come in somewhere outside the range shown in alternative B. If anyone was making a different proposal than that, I didn't understand it.

MR. PARTEE. That was my understanding too.

MR. BALLES. So, we aren't talking about making major overt moves to accelerate the rate of monetary growth, which I agree would be untoward. We'll never get to 1984 if we have a big LDC debt crisis in the fourth quarter of 1983. I think we have to deal with these things one at a time. I'm not talking about any extreme measures, but a shading in favor of easing a bit in the immediate future if we can, given the behavior of the aggregates.

CHAIRMAN VOLCKER. Where is October [M1] starting from in terms of the September level?

MR. AXILROD. The latest figure published for the 21st is just barely above the August level. On September 28th a further increase is what we would forecast and, for what it's worth, a rather strong increase on October 5th. There's some doubt about all that. But that would give you an October level well above--by about $5 billion--the September average level, which would suggest a strong October growth of a little over 10 percent.

CHAIRMAN VOLCKER. Over 10 percent.

MR. AXILROD. But we're not projecting that.

MR. PARTEE. You had 6-1/2 percent.

MR. AXILROD. Most of the forecasters don't believe it and the rest of the projections assume a drop after the October 5th week. But if that [unintelligible]--

CHAIRMAN VOLCKER. Let me give you a calculation, which you don't have. Given an assumption that the 28th is a little higher than the 21st, if you increased it by $1-1/2 billion a week in October, would it be over 7 percent?

MR. ROBERTS. Yes, because $2.8 billion is 6-1/2 percent.

MR. AXILROD. I think $1 billion a week--

CHAIRMAN VOLCKER. That's the average.

MR. AXILROD. Yes, I'm sure it would be. I'd have to work it out.

MR. CORRIGAN. That would be almost 10 percent.

MR. AXILROD. Yes, that would be very high.

CHAIRMAN VOLCKER. Well, it depends upon where you start. The average--

MR. AXILROD. We'll just make the calculation.

MR. FORRESTAL. Mr. Chairman, if I may: There are an awful lot of uncertainties out there. And it would seem to me that the contingencies that might arise--for example, the LDC crisis or something like that--can be dealt with on a conference call and a special meeting of the Committee. But I really have two concerns. One is the strength of the economy. As I said before, we tend to see the economy growing more rapidly than perhaps other forecasters. The forecast for the second quarter was certainly not very accurate. It came in at 9.7 percent, appreciably above what people thought. So, that's a worry that I think we ought to have. The other concern to me is that [we ought not just] look at the growth of the monetary aggregates over the last couple of months alone but back up and look at what has been happening to monetary growth since August of 1982. In the period from August '82 to June '83 we had very rapid monetary growth. So, it seems to me when we're deliberating about a specific policy option, we have to take into account those two periods of time. Because the aggregates in the short term--and I guess even in the long term--are within the targets, there doesn't seem to be any particular need to have a more restrictive policy at this time. On the other hand, since we have had some accommodation--some ease in the monetary aggregates and some base drift, I might add, in rebasing--I think it would be premature to ease at this time. So, I would opt for a target somewhere between "B" and "C." If we did that, we would be able to come in somewhere near the middle of the range for M1. If my numbers are right and if that kind of policy were followed, it seems to me that M1 growth would still not be restrictive over the long term. M1 could grow at a little over 6 percent from September to December and still reach the midpoint of the target range. That still would imply fourth quarter-to-fourth quarter growth of about 10.4 percent, so such a policy is still not restrictive in any sense. What it comes down to in my mind is that we ought to opt for a steady-as-you-go policy and not change policy at this time. And as I say, the contingencies that might arise can be dealt with specifically.

MR. ROBERTS. But "B" already has the fourth quarter down to 5.6 percent, dependent upon December being at an 8 percent growth rate. I'd go the other way and say the risk is that it's going to be too tight.

CHAIRMAN VOLCKER. Well, I think we have decided on the $650 million, generally interpreted as $600 to $700 million.

MR. GUFFEY. What does that mean, Mr. Chairman? Why set a range for borrowing at all?

CHAIRMAN VOLCKER. Well, sometimes strange things go on with excess reserves or otherwise.

MR. GUFFEY. It has no meaning. It's not a constraint up or down. We merely build the path on $650 million; I don't understand the range for the borrowing that we incorporated last time. To me it's meaningless. The policy that--

MR. STERNLIGHT. We use the range.

MR. GUFFEY. Well, you start out at the midpoint of the range and that's the only thing you really use until there's some consultation that suggests that the aggregates are coming in differently [than expected] and then you drop the borrowing. The last time we set the range at $700 to $900 million and then we went to $650 million. And that wasn't a policy decision of this Committee; it was done in consultation with the Chairman. Why set a range?

CHAIRMAN VOLCKER. Let's be clear; there may be some confusion about it. My interpretation is that this directive says we ease if things are coming in low or we tighten if they're coming in high. I don't interpret that as staying within the range that was set, which is an operating--

MR. GUFFEY. No, and that's my point. If it doesn't have any implication for staying within the range, why set a range?

CHAIRMAN VOLCKER. Well, it's not a big point to me. It doesn't make much difference, but sometimes we get in there and we ask: Shall we stick explicitly at $650 million this week when things are very tight and excess reserves are going to be high, or do we allow for a little higher excess reserves this week because that looks like what's going to happen? A little more borrowing or a little less is just fiddling around from week-to-week. I don't know whether it adds much; it's not a big deal one way or the other.

MR. PARTEE. It gives you a little movement around the mean. I might remind you that we're talking about a number that is not even in the directive. So what difference does it make whether it's a point or if we think of it as being a range of $100 million?

MR. WALLICH. Well, would the path then also have a range of $100 million?

MR. STERNLIGHT. If we use the individual weekly paths, they have a specific value over time.

CHAIRMAN VOLCKER. I have a distinction in my mind between a technical reaction to the patterns that are developing during the week, which has no real significance in terms of what we're aiming for, and whether we're really making a [policy] move, however small, because the aggregates are high or low. And it is meant to convey that. I don't care--we've operated both ways--whether we use a number or [a range]. It doesn't make much difference.

VICE CHAIRMAN SOLOMON. As I understand it, part of that technical problem--the reason for that modest shift in the borrowing assumption--can be that the System suspects there's a miss in the projection because of some peculiar movement in the fed funds rate which doesn't seem to be explained, unless there is some--

CHAIRMAN VOLCKER. We'll do it anyway because we're always sitting there saying: Well, which way are we going to miss? Which way are we likely to miss this week and which way are we going to be most misleading if we miss? So, we lean a little one way or the other sometimes. And we do that whether we put down $650 million or whether we put down $600 to $700 million. That kind of gives the range for that, but it's not a big deal.

MR. AXILROD. Mr. Chairman, in answer to your question: If we were so unfortunate as to have those $1-1/2 billion [weekly] increases--you remember $1 billion is to the top of the range, 9 percent--

CHAIRMAN VOLCKER. It clearly goes higher than the range, depending on where you start.

MR. AXILROD. On the assumption that there's a further increase in the week of the 28th, it would get you 14 percent growth if it steadily grew $1-1/2 billion through the course of that month.

CHAIRMAN VOLCKER. It sounds as if even if it were $1 billion, the growth would be pretty high.

MR. ROBERTS. Oh yes. The latest week is right on the September average.

CHAIRMAN VOLCKER. The latest week is on it, so if the next week is up--.

MR. ROBERTS. So if it's up, we're already above.

MR. AXILROD. We're not assuming that. You might say the fourth quarter we have there is consistent with what our local money market model would be projecting and roughly, not very far off, what the quarterly model would suggest. We've allowed for a bit of shift out of NOW accounts or demand deposits.

CHAIRMAN VOLCKER. What about the broader aggregates? Are they starting low or high?

MR. AXILROD. I'd have to find that nonexistent sheet. I'd have to go through the same exercise. M2 has moved up steadily over the course of September, so that would be starting on the high side of the average. And similarly for M3. Roughly, the early October level that we're estimating is [unintelligible].

CHAIRMAN VOLCKER. Well, you're telling me the chances are that we're going to be starting a little on the high side on all these aggregates, which makes it sound to me as though the chances are that October may come in a little high rather than the opposite.

MR. AXILROD. We put M2 and M3 a little high, again just allowing for the brief effect of this deregulation. But our models suggest growth in nontransactions balances in the 9 to 10 percent area--not really exceptional on a monthly average basis.

CHAIRMAN VOLCKER. Does this figure that you have in all these alternatives allow anything for deregulation?

MR. AXILROD. Well, as I was trying to say, in October we've allowed a little. We started allowing nothing and then after seeing some of the newspapers where there has been some advertising, in New York and other places like that, we've allowed some.

MR. GUFFEY. But only for M2 and M3?

MR. AXILROD. Well, we pushed down M1 a bit in [October], not much more than roughly 1/2 to 1 percentage point on our estimate in either case. It's a very small effect, but some effect.

CHAIRMAN VOLCKER. We could get pretty good growth in M2 and M3 in October. I guess that ought to be mentioned in the record as a minor effect. Well, I don't know whether we need to go any further. Unless somebody wants to change his or her mind, we're interpreting this in any event at around $650 million [in borrowing]. I don't much care whether we call it $600 to $700 million or around $650 million.

MR. BLACK. Mr. Chairman, you did ask one question about how we would treat overshoots and undershoots and I said symmetrically. I wonder if everybody agreed that we ought to react as quickly to an undershoot as to an overshoot or vice versa.

MR. PARTEE. I don't think they did.

MR. BLACK. I don't think they did either. There was a range of [views].

MR. MARTIN. I don't.

MR. GRAMLEY. Yes, there was a range of views.

MR. PARTEE. But if you literally look at this language, I think it's not too bad.

MR. BLACK. The language sounds fine but the--

MR. PARTEE. Well, the language is more permissive on the down side than on the up side.

MR. BLACK. Well, I didn't read it that way. In that case, it doesn't sound fine.

MR. MARTIN. Oh, yes.

MR. PARTEE. Oh yes, there's a modifier "somewhat" on the up side.

MR. GRAMLEY. "Somewhat" is all we ever do between these [meetings] anyway.

MR. PARTEE. Well, it's just that little [nuance].

MR. BOEHNE. Bob, have you learned--

CHAIRMAN VOLCKER. That's pretty subtle.

VICE CHAIRMAN SOLOMON. You could underline it.

MR. GRAMLEY. I wouldn't wish to change the language, even though I believe in going much less symmetrically, to make it consistent. I think everybody reads into these changes in language much more than they ought to.

MR. PARTEE. I said it originally in order to solicit Pres's support but now I've said it to elicit your support on the other side.

MR. BLACK. Well, I'm not voting, obviously.

CHAIRMAN VOLCKER. The only hesitancy I would have is that I would think we're more or less symmetrical but I would accept Governor Gramley's caveat that before we do anything we look and see whether the business picture tends to be consistent or inconsistent with the way the aggregates are going.

MR. PARTEE. Well, that's clearly true.

MS. TEETERS. Yes, that explains it.

MR. BOEHNE. Also, we should look at incoming information on the distortions that the deregulation might have on the aggregates.

MR. PARTEE. Well, that's a new thought.

MR. GRAMLEY. We don't really expect it to be enough to bother to put that in.

CHAIRMAN VOLCKER. I think we are probably covered on that if we make some mention in the policy record that we expect a small effect in the next few weeks but we don't expect it to amount to much. If we decided it mattered a heck of a lot, we would take it into account.

MS. TEETERS. We were so accurate on the MMDAs!

MR. GUFFEY. I would come out on the side of being a bit asymmetrical in the sense of not reacting to higher growth of the aggregates during this upcoming intermeeting period simply because the projections indicate that we're going to be within the long-run ranges unless the aggregates just explode on us. Then I think we'd have a conference call and do something about it. The other point is that we do have a federal funds target range of 6 to 10 percent and we're in the upper part of that already. And as a result, that range would not let us react to strong growth really as quickly as we could, it seems to me, if the aggregates came in somewhat lower. So, I would not react aggressively on the up side, if at all, but I would be more inclined to react in this intermeeting period on the down side if we saw the aggregates coming in a lot lower.

MR. AXILROD. Mr. Chairman, a further technical clarification on M2: That nonexistent kind of weekly M2 has not been rising as fast in the most recent weeks relative to a normative weekly growth as M1. So, if after the week of the 28th it grew at a rate which if sustained over time would give you 10 percent for a year, it would give you an October of around 9 percent. So, it's not biased as much toward an upward thrust in October.

VICE CHAIRMAN SOLOMON. I think we've gone as far as we can. I think we're verbally hitting the shadows. There is a slight implication of asymmetry in the language and I don't think there's much more we can do. We shouldn't start tinkering with that, I think. I don't know what more we can do.

CHAIRMAN VOLCKER. Well, I don't know whether I can postulate the median opinion as being a little less quick on the trigger on the up side than on the down side, all other things equal.

MR. ROBERTS. Very little less.

CHAIRMAN VOLCKER. I guess we can vote. We're voting for the specifications of "B" rounded off to 8-1/2 percent, with a mention in the policy record that 8-1/2 percent was shaded up a bit because of deregulation but we don't expect the effect of deregulation to be very significant. In explaining that first sentence we would indicate in the record that we had tended to ease a little. Otherwise, all the language is the same with the substitution of 8-1/2 percent for 8 percent and that new first sentence I read. There's a 7 percent where it was 7 percent and borrowing is $650 million or thereabouts.

MR. BALLES. Would you say that again please?

CHAIRMAN VOLCKER. I'm saying you're voting on the directive as it is with an 8-1/2 percent and a 7 percent number in there and with a new first sentence as I read it before: "The Committee seeks in the short run to maintain the slightly lesser degree of reserve restraint sought in recent weeks."

MR. BERNARD.

Chairman Volcker	Yes
Vice Chairman Solomon	Yes
Governor Gramley	Yes
President Guffey	Yes
President Keehn	Yes
Governor Martin	Yes
President Morris	Yes
Governor Partee	Yes
Governor Rice	Yes
President Roberts	Yes
Governor Teeters	Yes
Governor Wallich	Yes

CHAIRMAN VOLCKER. You have a tentative schedule for next year to which it is my understanding nobody has objected. And we thought we might begin on Monday next time even though it's in the middle of the quarter and discuss the inflation outlook in a little more depth. Let's start the next meeting on Monday afternoon.

MS. TEETERS. What's the date?

MR. BERNARD. November 14th.

MS. HORN. Mr. Chairman, I am giving a speech on Monday afternoon at the ABA, but you're suggesting having an FOMC session on Monday afternoon.

MS. TEETERS. What did you want to discuss in more depth?

CHAIRMAN VOLCKER. Inflation and the outlook. Expect to discuss inflation and come equipped to debate the issue, including maybe what we were intending to discuss, which is where we should go on inflation in a 5-year time perspective.

MR. KICHLINE. Whatever you like.

MR. PARTEE. To zero, I thought.

MR. KICHLINE. We thought we were going to cover some of these issues in depth in the spirit of trying to look at alternative views of the determination of wages and prices, as well as some of the issues that are debated among folks here as well as outside the Committee. For example, does the speed of activity matter in determining inflation and a few other issues.

CHAIRMAN VOLCKER. I think that's all fine. And you're also going to explain how we can get to a zero rate of inflation in the next--I'll be modest and say the next 5 years.

MR. BLACK. Be more symmetrical.

MR. CORRIGAN. No, it's a matter of being less symmetrical.

MR. BLACK. Yes, in the other direction.

MR. MORRIS. How many recessions can we assume?

MR. MARTIN. How much unemployment?

VICE CHAIRMAN SOLOMON. How many recessions do we need?

MS. HORN. We did pretty well in the Eisenhower years.

END OF MEETING